# BANK NEGARA MALAYSIA : THE FIRST DECADE



by

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TABLE OF CONTENTS

Page

## PREFACE

Quite a number of articles have been written on Bank Negara Malaysia, the Central Bank of Malaysia, since its inception in 1959. Before its establishment, however, it aroused a great deal of interest with the publication in 1955 of the World Bank Report on the Economic Development of Malaya which first mooted the idea of a central bank in Malaya and the Watson-Cains Report on the Establishment of a Central Bank in Malaya, which was published in 1956.

This present study attempts to survey the operation and activities of Bank Negara Malaysia after ten years in operation on the Malaysian monetary scene.

I wish to thank first of all my Supervisor, Inche Bagindo A. Mokhtar who had patiently supervised me in all stages of the work, even up to the last minute. Not to be forgotten also are my colleagues in Bank Negara Malaysia who had readily given me information and general help, without which my task would have been impossible.

LIST OF TABLES

LIST OF CHARTS

# CHAPTER I Background to Central Banking in Malaysia

In this introductory chapter, an attempt will be made to examine briefly the background to central banking in Malaysia, setting the stage from where we can trace the growth of Bank Negara Malaysia since it appeared on the Malaysian monetary and banking scene in 1959 till the present time (1969), a period spanning exactly a decade. In effect, what would be uncovered in the process of doing so is an account of the monetary and banking system of Malaysia prior to the setting up of a central bank in this country. To facilitate exposition, the brief survey will be classified into three main headings, namely :-

(a) The Currency Board System,

(b) The Commercial Banking System, and

(c) The establishment of Bank Negara Malaysia, the Central Bank of Malaysia.

The above institutions formed the main bulk of the monetary and banking structure of this country. The Currency Board and the Commercial Banking systems were the manufacturers of money in Malaysia: the former was responsible for the issue and redemption of currency, under statutory authority, not only in the former Federation of Malaya, British North Borneo and Sarawak (which now are united politically and economically into Malaysia), but also in Singapore and Brunei. In the case of Malaysia the Currency Board system no longer supply her with currency today; this important function having been taken over by the Central Bank of Malaysia since June, 1967. However, in Singapore and Brunei the Currency Board System are still adhered to, although this time under two distinct currency boards. Thus, a partnership in matters of a common dollar lasting more than three decades, under a common Currency is now broken. The Commercial Banking System was and still is instrumental in the creation and destruction of demand deposits (or bank money), an increasingly important component of a total money supply in the economy. Before the setting up of a central bank in this country, the commercial banks' credit policy was an independent one, without any supervision by a powerful monetary authority. However, with the establishment of central bank the situation is now changed. Therefore, one of the primary objectives of the Bank Negara Malaysia when it was established in 1959 was to supervise the whole monetary system, including the activities of commercial banks. By 1959, Malaysia therefore had a somewhat peculiar banking system, with a Central Bank, a system of commercial banks, and a Currency Board system. The existence of a Central Bank and a Currency Board side by side was a curious phenomenon. A Central Bank could rightly be given the power of currency issue right from the start. In fact, that was the intention of the drafters of the Central Bank of Malaysia Ordinance, 1958 - by which the Central Bank was established. However, the Bank had to wait for a little bit more than eight years, that is until June 1967 before it could be allowed to do so. The reasons for this are discussed later

It should be mentioned in passing that one notable group of financial institutions is left out of the above classification. This group consists of the non-commercial bank financial institutions such as the Post Office Savings Bank, co-operative socieities, finance companies, insurance companies and the like, all of whom should justifiably belong to the monetary system of the country. They are specifically left out of mention because they were not so active and data regarding their activities before the advent of central banking in Malaysia are not readily and systematically available. Nevertheless, they will be treated somewhat when we come to discuss the monetary and banking system of Malaysia after 1959 in Chapter IV below.

Before we proceed, it should be noted that in the description of the Malaysian monetary and banking system before 1959 must invariably include also that of Singapore and Brunei, the reason being that the monetary and banking systems were closely related. A common dollar circulated in all these territories. The Banking system was also closely related. Thus, a distinction makes analysis difficult.

## The Currency Board System

It was one of the outstanding features of the British South-East Asian currency system that a Currency Board operated in all the territories. This Currency Board system allowed for the automatic convertibility of Malayan dollars into pounds sterling (at a rate of \$1 - 2sh. 4d.) and vice versa. Another feature was the circulation in Singapore, Malaysia and Brunei of a common dollar which was backed by 100 to 110 per cent reserves.

How and when did Malaysia, Singapore and Brunei came to have this common Currency Board system? To trace its development, it is convenient to divide the history of the Currency Board system roughly into three periods :-

(a) Pre-Currency Board Period (1837 - 1899)

(b) Straits Settlements Currency Period (1899 - 1937)

(c) Currency Agreement Period (1938 - June 11, 1967)

The Currency Agreement Period can be further sub-divided into three, namely (i) The 1938 Currency Agreement, (ii) The 1950 Currency Agreement and (iii) The 1960 Currency Agreement.

### (a) Pre-Currency Board Period (1837 - 1899)

This period was characterised by the circulation of multiple currency not only in the Straits Settlements (Penang, Singapore and Malacca) but also the rest of South-East Asia. These currencies included the Spanish, Mexican, Peruvian, Bolivian, Hongkong. American, Japanese and British silver dollars. These silver dollars were valued by 'touch', that is by their silver contents. A brief note about how these silver coins came to be circulated in this region ensues.

The Spanish silver dollars were brought to South-East Asia by the Portuguese, who introduced them in Malacca in the 16th century and by the Spanish, who introduced them in Manila, from where they were also distributed to the South China ports of Canton, Ningpo and Amoy. They were known as Spanish silver dollars because they resulted from the Spanish conquest of silver-rich Mexico in the 16th century. The Spanish minted over 2,000 million coins between 1535 and 1821 and some of these found their way to South-East Asia via trading. When Mexico became independent in 1821, she also minted silver dollars identical in all respects with the old Spanish dollars, except in that they bore the Republic's insignia. These were known as Mexican dollars and also circulted in South-East Asia. What was the situation in the Straits Settlements then? As we know, the Straits Settlements were administered by the Government of India and as such India tried to impose the Indian rupees, into the currency system much to the annoyance of the local merchants and the other inhabitants. They refused to accept the rupees as a medium of exchange. A strange situation developed: the Government accounts were kept in rupees but all transactions between the Government and the public as well as among the public themselves were conducted in the then ubiquitous Mexican silver dollars, and to a lesser extent, other silver dollars as aforementioned. In 1867, when the administration of the Straits Settlements was transferred to the Colonial Office an opportunity presented itself to correct the malady. The previous currency legislation was repealed. The Indian Rupee was declared non-legal tender and in its place the various silver coins then in circulation were declared legal tender. However, the supply of the popular Spanish and Mexican dollars was not sufficient to meet demand owing to perhaps, the Asian's habit of hoarding and the rapid expansion of world trade in the 19th century. The currency shortage was brought to the notice of the Colonial Office. After numerous appeals, the British agreed to comply and set up a mint in Hongkong to issue what was known later as the Hongkong dollars. These dollars had an intrinsic value of silver equal to the Mexican silver coins. After about two million coins were minted the British abandoned the idea of producing some more of these Hongkong dollars, due to two factors. Firstly, the cost of minting was high and secondly, the Hongkong dollars were regarded as second-class by the population compared to the Mexican dollars and as such passed at a discount in the market.

After the Hongkong dollars ceased being minted by the British, the Japanese took over the mint in 1871. As a result, the Japanese trade Yen was born. Between 1871 and 1897, about 110 million coins were struck.

The United States of America, perhaps due to the success of the Mexican dollars, decided to mint their own version of silver dollars and export them. The Americans made one mistake, though. Their silver dollars were minted a little bit heavier than the Mexican dollars to ensure ready acceptibility. Owing to the higher silver content, the local people in the Straits Settlements melted them down, rather than circulating them.

The French also tried to produce silver coins, modelled unfortunately on the American silver dollars. As such the 13 million piastre de commerce or Saigon dollars produced in 1885 received the melting pot fate. To correct this mistake, the French minted from 1895 until 1903 the Mexican version of silver dollars. However, these were not legal tender in the Straits Settlements.

In 1895, the British tried again to produce silver dollars. The main reasons for this were first, there was a perennial shortage of currency to meet growing demand of trade in the Straits Settlements and Hongkong; and second, the Indian Government ceased to have silver as their monetary standard from 1893 onwards and as a result the Royal Mint in Calcutta and Bombay would remain idle. So making use of these facilities in India, 150 million British trade dollars were struck and circulated and declared legal tender in the Straits Settlements, Hongkong, Labuan, the Malay States and Borneo States. Thus at last, after a succession of different types of silver coins, the position of the popularity of the Mexican dollars was being threatened seriously by the British trade dollars.

Another notable feature of the Pre-Currency Board Period was the issue of paper currency (Bank notes) by the five British private banks then in existence. These banks were the Asiatic Banking Corporation, Oriental Banking Corporation, Mercantile Bank of India, Chartered Bank of India, Australia and China, and the Hongkong and Shanghai Banking Corporation. The charateristics of the bank notes were that they were not legal tender, redemption must be made by surrendering silver coins (then legal tender) in exchange and the note issue was small. The note issue was small (in 1881 and 1891 only $3.6 millions and 5.9 millions respectively were issued) because the issue was subject to unlimited liabilities of shareholders of the banks. It should be noted that the Asiatic and the Oriental Banks failed due to 'a run on the banks'. The rest remained in operation up to this day.

(b) Straits Settlements Currency Period (1899 - 1937)

Currency reform was undertaken in the Straits Settlements towards the turn of the 19th century. This was necessary because of two important factors. The first factor was that something must be done about the perennial shortage of currency in the Straits Settlements for trade purposes. Trade was expanding and needed more currency to carry out its functions more efficiently. Trade would be hampered if currency was not sufficient. The message was clear:- government must provide currency according to the needs of business. Another factor for a currency reform in the Straits Settlements was the failure of the note-issuing banks mentioned in the above section, that is, the Asiatic and the Oriental Banks. Because of these factors, the Government decided to take the responsibility of minting coins, which hitherto were exogenously minted, and issuing notes. A government note issue might help to alleviate the currency shortage of the colony. The Legislative Council of the colony termed it as 'a great convenience'. The note issue function of the government was at first resisted by the issuing banks, because their sole monopoly position was being eroded.

The currency reform came into the limelight with the passing of the Straits Settlements Currency Note Bill in 1899. This piece of legislation provided the Colonial Government to issue paper currency, which was readily acceptable by the public right from the start. The issuing banks, then in operation, were not allowed to issue bank notes when their license expired.

Thus the period saw the evolution of currency notes from the ones issued by private British banks to those printed by the Government. With respects to coins, the change was from a multiplicity of coins in circulation to a single coinage system. Another thing to note was that the colony's currencies circulated also in other British territories in South-East Asia, although the administration of the currencies was the responsibility of the Straits Settlements, operating through the Currency Board set up by the above Ordinance.

The Straits Settlements Currency Note Ordinance, 1899 became the model of all future currency legislation until the Central Bank of Malaysia Ordinance, 1958. This, in turn, was based on the British Hondurus model, introduced in 1894. It was declared by the Secretary of State that the British Hondurus Currency Note Ordinance, 1894 "was not originally drafted with special reference to circumstances of the British Hondurus but was intended to be a model Ordinance including those provisions which, in the opinion of the highest financial advisers of Her Majesty's Government, should be embodied in the law of any Colony proposing to establish a Government Note Issue". It is time now to examine the model.

According to the provisions of the Ordinance, there was to be what was known as the Note Guarantee Fund, consisting of two portions: the liquid portion and the Investment portion. The liquid portion, made up of silver coins and bullions, was used for the redemption of notes. On the other hand, the investment portion, designed to earn income for the government, was made up of British gilt-edged securities, other than securities of the Straits Settlements. The liquid portion was to be at a minimum of two-thirds of the total currency liabilities and this ratio could be reduced to one-half whenever the needs arose. In fact, this ratio was reduced to one-third in 1909, allowing more reserves to be used to purchase interest-earning assets. It should be observed, as a matter of interest, that the more the reserves kept in liquid form the easier it was to meet the redemption demands. But less would be available for investment to earn income. The size of income depended on the size of the investment portion of the Note Guarantee Fund. The higher the investment portion the higher would be income and vice versa.

In addition to the Note Guarantee Fund, there was also a Depreciation Fund. One per cent was to be set annually to be paid to the Fund, until a sum equal to ten per cent of the market value of the assets of the Note Guarantee Fund was reached. After this further additions were to be transferred to the Straits Settlements Government as revenue. On the other hand, if the Depreciation Fund and assets of the Note Guarantee Fund fell below 100% of currency liabilities, the Government had to make good the deficiency.

Therefore, there was a built-in safety valve in the system that currency in the Straits Settlements would be backed always by 100 - 110% of reserves. By this way, the rate of exchange would be fixed and the quantity of money available would be a function of net earnings from abroad.

If we compare the previous period (The Pre-Currency Board Period) and the present period under discussion, there was one notable change in the currency system of the area. This was the change from the silver standard to the gold standard. What brought about the switch in monetary standrds? The most important factor that was to result in the switch was the fluctuating price of silver at that time. A good monetary standard must be a stable one. When the price of silver fell sharply in 1893, merchants, bankers and the government began to get worried. Debates ensued as to the pros and cons of using either silver or gold as monetary standards. In 1903, that is ten years later, the Barbour Report was published giving recommendations regarding the issue. Generally, the Barbour Report recommended the switch to the Gold Standard or more specifically the Gold Exchange Standard. More specifically, the Report recommended the striking of Straits Settlements silver dollars having similar size, weight and fineness of the Mexican dollars to ensure the first pre-requisite of a good money - acceptability. When sufficient quantities were circulated, the old Mexican silver dollars could be removed. The import of the demonetised Mexican dollars was prohibited and the Straits dollars were, in turn, not allowed to be exported. The idea was to force the old silver dollars out of circulation and to divorce the value of the Straits currency with that of silver. Because of the above restrictions, the demand of the new silver dollars exceeded its supply, resulting in the rise in its intrinsic value. When the intrinsic value was not equal to its face value, the new silver dollars became a token money.

Another change was that the exchange rate of the new silver dollars was fixed at 2sh. 4d. to a dollar in terms of Gold, in 1906.

To summarise, the principal features of the Currency Board system up to this point (1906) were :-

(a) There was a Board of Currency Commissioners to manage the currency of the colony.

(b) The presence of the automatic expansion and contraction of the supply of currency, which depended on the amount of gold deposited to or withdrawn from the Board at the exchange rate 2sh. 4d. = $1.

(c) The Board guaranteed the stability of the currency by providing 100 to 110% backing.

(c) The Currency Agreement Period (1938 - June 11, 1967)

Another important landmark of the development of the currency Board system was the extension of membership of the Board, Although the Malay States used the same currency as that used in the Straits Settlements, they were not allowed to participate in the control and management of the currency. Appeals for participation were turned down. Initially, the Currency Board always incurred losses in currency operations, much to the liking of the Malay states, who had been refused admission to the system. However, this serve-you-right attitude of the Malay states turned sour, when for the first time, that is in 1926 the Board made a profit. Between 1929 - 1930, for instance, there was a net profit of $26 million. This, of course, encouraged the Malay States to try once more to participate in the Currency Board System. Sir Basil Blackett was asked to form a Commission to investigate the matter. Blackett made the following recommendations :-

(a) The Malay states were justified to participate,

(b) A formula of distribution of profits and the apportionment of losses among participants was calculated, based on the estimated currency consumption in each territory. This formula is given below :-

| | | |
|---|---|---|
| Straits Settlement | | 37% |
| Federated Malay States | | 37% |
| Perak | 16.75 | |
| Selangor | 12.75 | |
| Negri Sembilan | 4.50 | |
| Pahang | 3.00 | |
| Unfederated Malay States | | 25.25% |
| Johore | 9.25 | |
| Kedah | 7.00 | |
| Kelantan | 5.25 | |
| Trengganu | 3.00 | |
| Perlis | 0.75 | |
| Brunei | | 0.75% |
| | | 100.00% |

(c) The reserve backing of the Currency Board was changed to 100 - 115%.

All the above recommendations, except the last one (the maximum backing remained at 110%), were adopted. A joint Currency Board was set up in 1938 under an agreement among the governments of the Straits Settlements, the Malay States in the Malay Peninsula and Brunei. After a year in operation, the second world war broke out.

During the Japanese Occupation, the Japanese Government issued its own currency, known by many as the "banana" money, and declared it to be on par with the Currency Board dollars. What happened was that the Japanese money was regarded as inferior by the population, resulting in the classic case of Gresham's Law to operate. The good Currency Board money went underground, in private boards. The main purpose of the Japanese "banana" money was to run down the resources of the people and transfer them to the Japanese Government, through the illegitimate issue of currency, though at a cost of mounting inflation.

When the British returned after the war, the 1938 agreement was re-enforced. However, in 1950 a new agreement was convened to admit the Borneo States of Sarawak and British North Borneo into the Currency Board System and also to reflect the new political status of the Federation of Malaya (formed in 1948) and Singapore. The main provisions in the 1930 Currency Agreement were retained, including the retention of Singapore as the headquarters of the System. However, there were some minor changes. The old notes were demonetised and replace with a new series. The profit distribution formula was also modified to include Sarawak and British North Borneo by Dr. Frederic Benham, the Economic Adviser to the British Commissioner-General in South-East Asia, again based on the currency consumption by the participating countries. Thus, the Currency Agreement, 1950 widened the Currency Area having a common dollar, compared to the Straits Settlements Currency Board, which was controlled by the Colonial Office, although the Board currency was used in the Malay States as well. Compared to the 1938 Currency Board, the Currency Area was confined to Pan-Malayan States and Brunei only.

In the meantime, the Central Bank of Malaysia was formed in January, 1959. The Bank started operations without the powers of currency issue, even though the powers were clearly stated in the Central Bank of Malaysia Ordinance, 1958. Thus, an unique situation presented itself in the monetary and banking system of Malaysia - a Currency Board operating side by side with a central bank. However, the Central Bank had made it clear from the start that the powers of currency issue would sooner or later be taken over by the Central Bank. Since the establishment of Bank Negara Malaysia, the days of the Currency Board were numbered, as it were. To achieve this aim, the 1950 Currency Agreement had to be changed to allow for a withdrawal of a Participating country from the Agreement. The then Federation of Malaya successfully initiated a move to propose certain changes in the Currency Agreement. She wanted her new independent status (the Federation of Malaya became independent in 1957) to be reflected in the Agreement and she was right at that. At the same time certain changes could be made, including the withdrawal clause. So the 1960 Currency Agreement was convened and the following modifications were agreed upon by the participatin countries :-

(a) The 1950 Currency Agreement, as we had seen, had not provided for a withdrawal clause, if a participating country wished to have nothing to do with the Currency Board. Owing to the setting up of the Central Bank, the Federation of Malaya successfully moved a motion that an eighteen-month withdrawal clause be included in the new agreement. Any member could unilaterally leave the Agreement by giving this notice.

(b) The headquarters of the Currency Board system was changed from Singapore to Kuala Lumpur. Singapore had been the headquarters since 1837.

(c) The composition and vote distribution was also altered giving more powers to the Federation of Malaya. The Malaya British Borneo Currency Board comprised seven members of which two came from Malaya, one from Singapore, one each from Brunei, Sarawak and North Borneo while the seventh was to be a person appointed jointly by the five participating countries. One of the Malayan members was to be the Chairman and the Singapore member was to be the Deputy Chairman. The voting arrangements also put more weight on Malaya and Singapore each of whom were given three votes. The other participating countries got one vote each. A majority of seven votes was enough to pass a routine day-to-day decision. However, a major policy change required the agreement of all the members.

(d) The new Agreement also allowed for a fiduciary issue of $500 million in the first year, not more than $200 million in the second year and up to $300 million in the third year. This provision was not carried out, although it would permit the member-countries to release scarce resources for economic use. It would also provide some measure of flexibility in the Currency Board system.

(e) The 1960 Currency Agreement also provided for the diversification of the assets of the Currency Board. Throughout its history, due perhaps to Colonial policy, the investments of the Board had always been in sterling and sterling securities. This was also not carried out by the Currency Board, implying conservatism in the management.

So much about the evolution of the Currency Board system since the beginning of the 20th centuary till 1967, a period covering more than six decades. Now we are in a position to discuss the merits and demerits of such a system. The main advantage of the Currency Board system is that it provides for stability in the external value of the currency. The fluctuation in the external value of the currency is limited to the exchange spread, which is the rate at which the Board is obliged to purchase sterling and the rate at which it is obliged to redeem the Malayan economy such as Malaysia's, which is one of the most open in the world. This stability of exchange rate has facilitated the development and growth of external trade and the economy. The present modern economies of Malaysia and Singapore was the off-shoot of stable exchange rate. A fluctuating foreign exchange rate would have discouraged the inflow of foreign investment, enterprise skilled and semi-skilled labour and goods, and this would have seriously retarded the economic growth and transformation of Malaysia and Singapore.

The Currency Board system also had its demerits. The principal one is that it could not check the fluctuations in the interal value of money. An Automatic mechanism for the checking of any export induced boom, such as the one Malaysia experienced in the 1950's, or import induced slump, such as the one experienced in the 1930's. The system also has no control over the credit policies of the commercial banks and this too has its shortcomings. The expansion of credit at a time when it is not wise to do so might be detrimental to the economy. It might encourage inflationary tendencies. The direction of bank lending may not be to the advantage of the country, from the point of view of resource allocation. It is possible also that the banks, in the quest of maximisation of profits, may not care as to the state of liquidity of the banks and start lending without limit. This type of action certainly will bring disorder to the credit and monetary system of the country.

It was primarily to lessen and remove the short-comings of the banking system and those that arise from the Currency Board system in particular that the Central Bank of Malaya was established in 1959. It immediately took the proper steps, such as the imposition of a statutory reserve, minimum ratio of liquid assets, fixing rate of interest on deposits and advances, local assets ratio and qualitative advance policy.

(c) The Commercial Banking System

When Bank Negara Malaysia was formed in 1959, there was a fairly sound banking system in the country. There was a system of 20 banks, 16 banks were incorporated outside the then Federation of Malaya and 4 incorporated locally. The distribution of branches of both local and foreign banks is shown in the table below.

TableI.I Distribution of Commercial Bank Branches, state-wise in Malaya as at 26th January, 1959.

| States | Federation Banks* | Other Banks* | Total |
|---|---|---|---|
| Johore | 1 | 7 | 8 |
| Kedah | - | 3 | 3 |
| Kelantan | - | 2 | 2 |
| Malacca | - | 6 | 6 |
| N. Sembilan | 1 | 3 | 4 |
| Pahang | - | 7 | 7 |
| Penang | 1 | 11 | 12 |
| Perak | - | 13 | 13 |
| Perlis | - | - | - |
| Selangor | 3 | 22 | 25 |
| Trengganu | - | 1 | 1 |
| Total .. | 6 | 75 | 81 |

Note and Source:

* 'Federation banks' are those whose head offices are situated in the Federation of Malaya.
'Other banks' are those whose head offices are situated outside the Federation of Malaya.

Bank Negara Tanah Melayu: Annual Report and Statements of Accounts, 1959, Page 12.

How did the above system evolve ? To trace the evolution of the commercial banking system in Malaya as well as Singapore, it is convenient to divide the discussion into roughly three periods:

(a) First Period: 1840 - 1900

(b) Second Period: 1900 - 1950

(c) Third Period: 1950 - 1958

(a) First Period (1840 - 1900)

The first bank to be established in this region was a branch of the Union Bank of Calcutta in 1840. This bank, set up in Singapore, ceased operation after a few years. However, between 1846 to 1884 a number of Western banks were established. The first to come on the scene was the Oriental Bank in 1846. Then came the Mercantile Bank of India, London and China (1885), Chartered Bank of India, Australia and China (1859), Asiatic Banking Corporation (1866), Commercial Bank of India (1866), Nederlandse Handel Maatschappij (1883) and the Hongkong and Shanghai Bank (1884); all of which were established in Singapore. Out of these seven banks, three experienced 'run on the bank' and had to cease operation. The unfortunate banks were the Oriental Bank which was closed in 1884, Asiatic Banking Corporation (1886) and the Commercial Bank of India (1866). The reasons for the failures were the banks' speculative activities, meagre capital resources and unsound management. The rest especially the three British banks (Mercantile Bank, Chartered Bank and Hongkong and Shanghai Bank) did well till this day. The success of the three British Banks could be attributed to the following factors :-

(i) The banks were well managed and organised. The Banks' capital was always adequate to meet obligations, including obligations of bank note issue. They kept large sterling and sterling securities balances to enable them to transact foreign exchange business in British territories.

(ii) They also enjoyed the co-operation and good faith of the Straits Settlements Government and the British Colonial Office. Their expert advice were often sought by the Government regarding economic and financial matters. To top it all, their officers were sometimes appointed to sit in the Board of Commissioners of Currency.

(iii) Their policy of orientating their outlook towards China, Hongkong and Japan, instead of India, in trade and finance paid handsome dividends. The volume of trade was much bigger in the former areas than in the latter area.

Another characteristic feature of commercial banking in the period was that different groups of foreign banks, in general, were set up with the main interest of financing trade between their home countries and overseas territories, on the one hand, and the Straits Settlements on the other. Two examples may be cited. The Dutch Banks (Nederlandes Handel Maatscappij, Escompto, N.I. Handelsbank) were active in financing trade between the Dutch East Indies and the Straits Settlements. The First National City Bank of New York (set up in Singapore in 1902) also played an active part in the trade between the Straits Settlements and America.

The banks of the period under review were conservative and cautious in their lending policy. Only short-term loans on good collateral securities were extended to customers. Long-term lending was shunned as too risky.

(b) Second Period (1900 - 1950)

This period saw the rise of local banking in Malaya and Singapore. Also it may be noted that the Straits Settlements Dollar was introduced in 1903.

The first local bank (all of whom were started by the local Chinese) was the Kwong Yik Bank, which was opened in 1903 in Singapore. This was followed three years later by the Sze Hai Tong Banking and Insurance Limited, also set up in Singapore. Later, due to the growing demands for commercial banking services by the expanding Chinese business community, a surfeit of banks was established. In the 1910's three banks appeared: The Chinese Commercial Banking Limited, Ho Hong Bank and Chinese Overseas Bank Limited. In the 1920's, the Lee Wah Bank Limited, Batu Pahat Bank Limited and Bank of Malaya were incorporated in Singapore, Batu Pahat and Ipoh respectively. During the Great Depressi on in the 1930's the Oversea-Chinese Banking Corporation, which later was to become one of the strongest local banks in Malaya and Singapore, was established in Singapore. The bank was the result of an amalgamation of the three banks established in the 1910's above. In addition, the Ban Hin Lee Bank Limited and the United Chinese Bank Limited were formed both in 1935. To complete the picture, two more Chinese banks were set up. These were the Oversea Union Bank and the Chung Khiaw Bank Limited in 1949 and 1950 respectively.

What were the characteristics of the local Chinese Banks? Let us examine them now.

Firstly, the growth of the Chinese banks was endogenously induced, that is to say, the factors that brought about their establishment were local ones. E.g. the growth of the rubber and tin industries were responsible for the formation of these banks. Secondly, they were commercial banks in the real sense of the word, that is, they were not just remittance houses so characteristic of banks in China and Hongkong. They in fact, carried commercial banking functions almost similar to those of the British banks. Thirdly, there was what was known as "dialectic groupism" in local Chinese banking. The banks tended to be started by people of a certain Chinese dialectic group (Cantonese, Teochew, Khek, etc.). In the beginning, not only were the directors and officers of the banks but also the customers were from the same respective communities. Certain examples are given here. The Lee Wah Bank and the Kwong Yik Bank were formed by the Cantonese, whilst the Chinese Commercial Bank

Ho Hong Bank and Overseas Chinese Bank were started by the Hokkien. One of the earliest banks - Sze Hai Tong Bank was a Teochew concern. Fourthly, the liquidity positions of the banks were rather high. This was because of the nature of the Malayan economy, which was export oriented and as such subject to the fluctuating fortunes of local commodities in the international market. Finally, arising from the fluctuating nature of the economy, the lending policy of the banks was a cautious one. Overdrafts were given on personal and communal basis, which now-a-days would be considered as an unsound banking practice.

Meanwhile, the growth of the three British Banks was unhindered. But besides these, other foreign banks also developed. Two such banks were founded in Malaya, namely the P. & O. Banking Corporation, set up by a shipping company in 1920 and the Eastern Bank in 1928. It should be noted in passing that the British banks were important in this region because it could help in expediting the inflow of British capital into Malaya and also it could serve as a link between the money and capital market in London and the development of the Malayan economy.

(c) Third Period (1950 - 1958)

The commercial banking system in Malaya and Singapore continued to expand during this period. In Malaya, the number of banks increased from 13 to 20 and in Singapore the increase was from 21 to 30 bank offices. This period also saw the establishment of branch offices in both these territories by the banks of a number of Asian countries. In 1957, the Bangkok Bank Limited, whose headquarters was and still is in Bangkok was established in Singapore. Also, in that year the Bank of Tokyo set up a branch in Singapore. The Bank Negara Indonesia was incorporated in Singapore in 1955.

This was the position of the commercial banking system in Malaya and Singapore until the establishment of the Central Bank of Malaya in 1959. A brief summary about the commercial banking system would not be altogether out of place.

Summary

In the early development of commercial banks in the Malaya-Singapore region, the main function of the banks was to deal in foreign exchange, that is, to remit money and finance export and import bills of exchange. It was for this reason that they were known as "exchange banks". Export trade then composed of such commodities as opium, pepper, spices, gambier and other Straits produce, in which the exchange banks were active. Later, the composition of export trade changed. Tin became important as an international commodity after the First World War, and so too was rubber after the 1920's. Here the exchange banks, especially the three British banks, played and important role in the development of the tin and rubber industries by channelling the flow of capital from abroad.

Another important function, as we saw when we discussed the Currency Board system earlier on, was the issue of bank notes in the Straits Settlements by the five British banks, complementing the silver coins then in use as a medium of exchange. With the introduction of the 1899 Straits Settlements Currency Board, the issue of the paper money was stopped in 1904. The issue of the paper money, though small, did much to alleviate the perpetual currency shortage for trade purposes in the Straits Settlements.

The period 1900 - 1950 witnessed the establishment of local banks by the Chinese, as a result of growing demands of local trading. They displayed certain characteristics peculiar to them as we already saw. Parallel to the growth of the local Chinese banking was the continued development of the foreign-controlled Western banks. The local and the foreign banks together formed the nucleus of an integrated banking system until the present time. The commercial banking system successfully weathered the storm of the Great Depression in the 1930's despite the inability of the Currency Board system to influence general credit policy of the commercial banks, due to its very nature. Generally banks followed a very cautious credit policy, that is, credit expansion during a boom and otherwise during a slump.

The lending policy of the banks qualitatively was also somewhat conservative. They were willing to provide short-term credit for trade and commerce (commercial sector) but unwilling to take the risks of finalising medium and long-term investments projects (industrial sector). In other words, they were very careful of their liquidity margins. The commercial bank system was inactive in the field of channelling local funds or deposits to finance local industries. Instead they preferred to invest in overseas securities (almost if not all in sterling and sterling securities). The non-availability of local investment outlets was offered as an excuse.

However, with the setting up of a central bank to supervise the commercial banking system, it was hoped that the outlook and policy of the banks would be changed, as in fact they did as we shall see later.

<u>The establishment of Bank Negara Malaysia, the Central Bank of Malaysia.</u>

The Central Bank of Malaya Ordinance, 1958 was passed in October, 1958, and the following complementary Banking Ordinance, 1958 which regulated the business of licensed banks in the former Federation of Malaya was passed in December, 1958, To complete the picture, the Currency Agreement, 1950, which set up the then Board of Commissioners of Currency, Malaya and British Borneo was also passed. These three pieces of legislation governed the monetary system of Malaya and integrated the three institutions which they controlled (Central Bank, commercial banks, and Currency Board) into a coherent whole.

The Central Bank of Malaysia (formerly known as the Central Bank of Malaya) came into existence officially on January, 24th 1959 and commenced operations on January, 26th 1959. The Bank was officially opened by the First Paramount Ruler of the Federation of Malaya, who said among other things, "The establishment of Bank Negara Tanah Melayu will undoubtedly go down in history as one of the most significant events which have taken place since Merdeka. As the Banker and Financial Adviser of the Government, Bank Negara Tanah Melayu will have great responsibilities and a vital role to play in the economic and financial affairs of the country ...."[1] The idea of a Central Bank for Malaya has been first mooted in the Report of a Mission from t the International Bank for Reconstruction and Development (in short the World Bank Report)[2] which visited Malaya and Singapore in 1955. The proposal was supported by both the governments of the Federation of Malaya and Singapore, who appointed Sir Sydney Cains, formerly Vice-Chancellor of the University of Malaya, and Mr. G.M. Watson, formerly Chief of the Overseas Department of the Bank of England to report on the establishment of a Central Bank in Malaya.[3]

Both the World Bank Mission Report and the Watson-Caine Report favoured the establishment of a single Central Bank for Malaya and Singapore because of the long economic and financial links between the two territories.[4] However, the pace of political development with Malaya achieving independence in August, 1957, whereas Singapore obtained internal self-government in May, 1959, resulted in the Central Bank of Malaysia being established for the Former Federation of Malaya alone. However, this was done after due deliberation and consultation with Singapore and obtaining the opinion of the banking community in the country as well as expert advice from several central banks among the Commonwealth, especially the Bank of England, the Commonwealth Bank of Australia and the Reserve Bank of India. Academically, the idea of a central bank in this area resulted in the publication in 1957 of an independent study of the monetary system in Malaya by Mr. Frank H.H. King in his book - "Money in British East Asia"[5]. This book, the Watson-Caine Report and the relevant sections in the World Bank Mission Report provoked an excellent debate on the Malayan monetary problems in the Malayan Economic Review (1957 - 1959 issues)[6], which directly or indirectly helped to shape the future role of the Central Bank.

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1 Extracted from the English translation of the speech by His Majesty the Yang di-Pertuan Agong at the official opening of the Bank Negara Tanah Melayu on 24th January, 1959.

2 International Bank Mission, Report on the Economic Development of Malaya, Singapore: Government Printer, 1955.

3 G.M. Watson and Sir Sydney Caine, Report of the Establishment of a Central Bank in Malaya, Kuala Lumpur: Government Printer, 1956.

4 There was and still is an 'accession' clause in the Central Banking Ordinance to allow for the future participation of Singapore, or any other territory, in the Bank.

5 Frank H.H. King, Money in British East Asia. London: H.M.S.O., 1957.

6 All these articles are now found in a single book. See P.J. Drake (Ed.) Money and Banking in Malaya and Singapore. University Handbook Series on Malaysia and Singapore, Series 2, 1966.

Objectives and Functions of the Central Bank

The principal objectives the Central Bank is to promote monetary stability and a sound financial structure in the country. It is also responsible for influencing the size of the money supply and the availability and cost of credit to the national advantage. Other functions of the Bank are to issue currency and to maintain reserves to safeguard the value of the currency, to act as fiscal agent of an financial adviser to the Government, to be banker to the commercial banks and to supervise the operation of the banking system throughout the country.

Relations with Commercial Banks.

The Central Bank is provided with wide powers for the regulation of the banking system and ensuring a high standard of banking services for the public. Thus the Bank is empowered to regulate the volume of bank credit by requiring banks to maintain statutory reserves with the Central Bank, to observe a liquidity ratio and a local asset ratio. Bank Negara may also prescribe the structure of interest rates and influence the direction of bank lending.

Regular inspections of banks are carried out by the Bank Supervision and Internal Audit Department, thereby discharging its responsibilities of protecting the interest of depositors and of fostering a high standard of banking comparable to that of the West, The stautory reserves ratio, as an instrument of monetary policy, is subject to change. An example of the change is found when the Bank reduced the ratio of 4% to 3½% from the 16th of February, 1965. This was done not to indicate a policy of monetary ease on the part of the Bank but was rather a measure of assistance of the commercial banks to reduce the burden of complying with statutory requirements on a Malaysian basis (Malaysia was formed then).

The ratio of liquid assets which commercial banks in the states of Malaya had agreed to maintain was 20% of the deposit liabilities. For calculating this liquidity ratio, banks were allowed to include Government securities up to a maximum amount equivalent to 5% of deposit liabilities. At the time when the liquidity ratio requirement was applied on a Malaysian basis from 16 - 2 - 1965, the Central Bank decided to reduce the liquidity ratio to 20% of deposit liabilities, but at the same time to change the basis for calculating this ratio. Only Malaysian liquid assets quality for inclusion in the calculation and government securities up to a maximum of 10% of deposit liabilities could be included. Subsequently, as a means of encouraging housing loans as a form of investment for savings banks funds, housing loans to individuals and to approved housing societies up to not more than 10% of each bank's savings account balances were allowed to be included in the calculation of the liquidity ratio.

Prior to the advent of central banking in Malaysia, interest rates of commercial banks in Malaya and Singapore had tended to automatically follow changes in the British Bank Rate. When the

Central Bank appeared more cautious policy had been adopted to relate changes in interest rates to the economic interest and needs of the country. However, because of the freedom of movements of funds from Malaysia to the sterling Area countries and through sterling to other countries, Malaysia cannot ignore changes in the interest rates in the major financial centres of the world, particularly London. Later we shall see that changes in fact occur as a result of exogeous changes in interest rates.

Bank Negara is a Bankers' Bank and as such commercial banks in the country keep clearing accounts, in addition to the statutory reserves account, with the Bank. Clearing Houses are provided by the Bank in Kuala Lumpur and in areas where the Bank has a branch office. The setting up of this service is to facilitate the settlement of inter-bank indebtedness. When Singapore was part of Malaysia similar services were also extended to the banking system there.

As a Bankers' Bank, Bank Negara also provides lender-of-last resort facilities to the commercial banks. The Bank stands ready to rediscount Treasury Bills for the banks and also to give them advances against acceptable security if this proves necessary.

As an added service to the commercial banking system in Malaysia, the Bank assumes the responsibility for the provision of cash required by the banks and for the acceptance of surplus cash from them. The Cash Department of the Kuala Lumpur Branch performs this function for banks in the Kuala Lumpur area. The Penang, Johore Bahru, Kota Kinabalu and Kuching Branches of the Central Bank serves their respective areas, in connection with this function. The need for the banks to have recourse to the Currency Board for cash, when the Board was sole issuing authority of currency in Malaysia at that time, has therefore been eliminated.

Relations with the Government

Bank Negara Malaysia at present serves as a banker to the Central Government in Kuala Lumpur and Penang and to the State Governments of Selangor, Johore, Sabah and Sarawak. In addition, the accounts of several statutory bodies, such as the Majlis Amanah Rakyat Bumiputra Malaysia (MARA) and Malaysian Muslim Pilgrimage Fund (Tabong Haji), are also maintained at the Central Bank and its branches.

Bank Negara Malaysia acts as the Government's financial adviser and is the agent of the government for the raising of publicly issued external loans. It also advises the Central Government on the timing, the amount, the maturity spread and the interest rate structure for domestic loans. Further, it also manages the local funded of the Central Government through its Public Debt Section. This function was previously undertaken by the Accountant-General's Department of the Central Government. Under the Malaysia Act, domestic loans raised by the State Governments of Singapore, Sarawak and Sabah require the prior approval of the Central Bank. In the case of Singapore, for obvious reasons, this provision no longer applies.

The Central Bank is now the agent of the government to administer the Foreign Exchange Ordinance, 1953. For this purpose, the Foreign Exchange and Exchange Control Department was set up to undertake this function.

Bank Negara Malaysia maintains very close liaison with the Treasury as well as with other ministries dealing with planning and development as well as trade. That is why the Central Bank is being called upon from time to time to advise the Central Government or sometimes the State Governments on financial matters. The Governor and senior staff members sit on many governmental committees concerned with national planning, trade policy, company legislation, industrial development and other important economic and financial matters.

## Currency

Bank Negara Malaysia became a full-fledged central bank when it commenced to issue currency for Malaysia on June, 12, 1967, after a lapse of eight years in operation. Why has the Bank to wait that long to issue its own notes and coins? The answer is it was felt that it would be unwise at the time of its inception in 1959 for Bank Negara to have this power and thus sever its monetary ties with Singapore and the Borneo States. It was thought that there should be a "breathing space" for full consideration of matters connected with the country's economic and financial ties with Singapore and other adjacent territories before a final decision was taken. Thus, the Board of Commissioners of Currency enjoyed the right of currency issue, although there was a Central Bank in operation.

## Conclusion

The role of the Central Bank as the fulcrum of the entire banking system and also as the main authority on policies relating to monetary management including currency makes it the foremost financial institution, which in co-ordination with the fiscal and budgetry policy of the Central Government, is responsible for the financial health and prosperity of the country. Later we shall see whether the Central Bank has performed this role well or otherwise, after a decade on the Malaysian monetary scene to merit the title "foremost financial institution".

## CHAPTER II Introduction to the Internal Organisational Structure of Bank Negara Malaysia

### Introduction

Bank Negara Malaysia is a statutory body, like the Employees' Provident Fund, Federal Industrial Development Authority, National Electricity Board (to name only a few). It was established, under authority of Parliament, by the provisions of the Central Bank of Malaysia Ordinance 1958, as we already noticed in Chapter One. Its modes of operation, administration, powers and duties are governed and authorised by this Ordinance. Its Head Office is in the Federal Capital, Kuala Lumpur and at present, it has branches in Penang and Johore Bahru in West Malaysia, and Kuching and Kota Kinabalu in East Malaysia. In addition, it has a Fort Knoz-type storage building for currency at Batu Tiga, near Kuala Lumpur. When Singapore was part of Malaysia, there was a branch there. However, since April, 1967 the branch ceased to operate. Plans are underway to set up branches in Kuantan, Ipoh and Malacca to extend central bank services to the State Governments and commercial banks in such places.

Since Bank Negara Malaysia is a statutory body, all the shares of the Bank are wholly owned by the Government. Profit-making is not the main objective of the Bank, as compared with commercial banks which have to make profits to please share-holders and to keep them in business. Compared to commercial banks again, deposits-taking and lending functions are not the primary functions of Bank Negara Malaysia. It can only accept deposits from commercial banks (Bankers' Bank) and governmental organisations (Bankers to the Government). Contrary to general belief, the Bank does not accept deposits or perform other banking services for the man-on-the-street.

Policy-making and general administration of the affairs and business of the Bank are entrusted to a Board of Directors, as laid down by the provisions of the Ordinance. The Board may consist of between seven and ten persons, including the Governor and Deputy Governor, and the Permanent Secretary to the Treasury.[1] In 1959, when the Bank was first established, the Board consisted of only six members; the Deputy Governor was still not appointed at that time. When he was appointed by the Yang di-Pertuan Agong in November, 1960, the Board of Directors acquired the required strength of seven members (the minimum number stipulated by Section 8(2) of the Ordinance) up to the present.

Directors "shall be persons of standing and experience in affairs, and as directors of the Bank shall not act as delegates on the Board from any commercial, financial, agricultural, industrial or other interests with which they may be connected: Provided that such prohibition shall not extend to any director holding or the time being acting in the office of Secretary or Deputy Secretary to the Treasury."[2] This governs the qualification of the Directors.

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1 Section 8(2) of the Central Bank of Malaysia Ordinance, 1958

2 Sec. 10(2) ibid.

Other than the Permanent Secretary to the Treasury, who is appointed ex-officio for an indefinite term, a director is appointed by the Yang di-Pertuan Agong for a term not exceeding three years, and is eligible for reappointment.[3] The Governor and Deputy Governor are each appointed for a term not exceeding five years, and are eligible for reappointment.[4] The reason for the indefinate term for the Permanent Secretary to the Treasury is to ensure unbroken relationship between the Government and the Central Bank. This is essential for a correct balance between fiscal and monetary policy.

Under Section II(1) of the Ordinance, members of the Senate, House of Representatives of any Legislative Assembly, directors or salaried officials of any bank licensed under the Banking Ordinance, 1958, or holders of full-time office in any public service are disqualified from becoming the Governor or Deputy Governor or directors of the Bank. The Secretary or Deputy Secretary to the Treasury, although full-time officers of the Government are exempted from this provision. The present Governor of the Bank is a seconded officer from the former Malayan Civil Service.

The Governor or, in his absence the Deputy Governor, as Chairman of the Board, "shall summon meetings as often as may be required but not less frequently than once in each month."[5] The Board "shall be responsible for the policy and general adminstration of the affairs and business of the Bank."[6] "The Governor and Deputy Governor shall be answerable to the Board for their acts and decisions,"[7] and the Governor or, in his absence or inability to act from illness or any other cause, the Deputy Governor, "shall be entrusted with the day-to-day administration of the Bank ....."[8]

So much about the appointment, composition, qualification and disqualification, and meetings and acts of the Board of Directors, as stipulated in the Central Bank of Malaysia Ordinance, 1958.[9] Now let us turn to the internal organisation of the Bank.

Internal Organisational Structure of Bank Negara Malaysia

The present organisational structure of the Bank can be found in Appendix A. This structure has evolved over the last ten years from a dkeleton framework in 1959. However, the first Governor[10] of the Bank and some expatriate officers from the Commonwealth Bank of Australia did well to set up a solid foundation for future development. With 67 staff (59 of whom were Malayan citizens), the then

[3] Sec. 10(3) ibid. of the Central Bank of Malaysia Ordinance, 1958

[4] Sec. 9(2) ibid.

[5] Sec. 13(I) &(2) ibid.

[6] Sec. 8(I) ibid.

[7] Sec. 8(4) ibid.

[8] Sec. 8(3) ibid.

[9] At present, all the provisions of the Ordinance are in force, including Part Three (on Currency) with the assumption of the currency-issuing powers of the Bank in June, 1967.

[10] The first Governor of the Bank was Dato' W.H. Wilcock.

Bank Negara Tanah Melayu, the Central Bank of Malaya, was launched. There were seven departments or sections to start with. The departments or sections were the Secretary's Department (with the Secretary as head of department), Chief Accountant's Department (Chief Accountant), Banking Department (Manager), Economic Section (Economist), Banking Operations Department (Superintendent), Exchange Control Section (Assistant Controller), and Foreign Exchange Section (Superintendent). This set-up became the model, as it were for future development. Tracing briefly the development of the organisational structure will not be superficial, as is done below.

The only two departments that have not undergone substantial changes, at least in their designations, are the Secretary's Department and the Banking Department. As the Organisation Chart in Appendix A will show, they are still known by these designations. This is because there was conscious planning from the start with regards to them. A department had to be set up to administer the Banking Ordinance, which was passed at the same time as the Central Bank of Malaysia Ordinance (by which the Bank was established) and both became operative at the same time (that is, in 1959). By this means, the affairs and business of commercial banks in the country could be regulated, and the department of the Bank that was to carry out this function was the Banking Department. Also, a department must be established to deal with Board matters. Thus the Secretary's Department came into being, at the inception of the Bank.

Another essential department for a Central Bank to function smoothly was the Chief Accountant's Department.[11] Primarily, it was formed to assume the accounting functions of the Bank. However, besides these the department was also responsible for personnel, premises and supplies management when the Bank was first established. It was not until towards the end of September, 1961 that the management of such matters came to be entrusted to a new department known as the Establishment Department. This was done because staff and premises and supplies matters were becoming too big for the Chief Accountant to handle, due to the expansion of Bank's activities.

The setting up of the Bank Supervision Section was made possible through the expert advice of two seconded officers from the Reserve Bank of India. It was formed in 1961, with an Inspector as its head. Later on this section was expanded due to increased inspections of commercial banks. It was redesignated and given the status of a full department, with a Chief Inspector to supervise it. At present it is known as the Bank Supervision and internal Audit Department.

The formation of the Economic Research Department was largely the work of an officer seconded from the Reserve Bank of Australia. Now, however, the department is completely Malaysianised.

The Foreign Exchange and Exchange Control Department started off as two separate sections, both headed by contract officers from the then Malayan Civil Service. The department was staffed originally by officers absorbed from the Treasury.

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11 Now known as the Accounting and Investments Department.

The Kuala Lumpur Branch of the Bank was a department of the Bank, when it first commenced business and was known as the Banking Operations Department. It carried out the more familiar banking services as are found in an ordinary commercial bank. However, as business grew tremendously it was turned into a branch and as such it came under the span of control of the accounting and Investments Department, which coordinates and controls branch operations.

The newest and latest addition to the organisational structure of the Bank is the Currency Operations Department, formed in the middle of 1967 when the Bank assumed the power of currency issue. An expert from the Bank of England was engaged to assist in the planning and implementation of the arrangements for the issue of the new Malaysian currency to replace Currency Board notes and coins which had been in circulation then. In his stride, the expert helped establish the Currency Operations Department, which was responsible for the indent, storage and distribution of the new currency and destruction of old notes. By the time he left in October, 1967, the department was functioning smoothly. The day-to-day administration of the department is now entrusted to a Currency Officer.

For the current organisational structure of the Bank and the general functions of each department, Appendices 'A' and 'B' are referred to.

It will be noticed that at the apex of the structure is the Governor, who is the Chief Executive of the Bank. The Governor, assisted by the Deputy Governor, are answerable to the Board of Directors for the routine administration of the Bank. They may make decisions and exercise the Bank's powers, but always subject to the provisions of the Central Bank of Malaysia Ordinance, 1958. In addition, the Governor may assume other functions such as becoming the alternate Governor of the International Monetary Fund and of the Asian Development Bank for Malaysia.

Apart from the Deputy Governor, there are presently two Advisers whose job it is, as the name implies, to advise the Governor on broad policy or other matters. They may sit as Chairman on committees, such as the Bank's Selection Committee for appointment or promotion of staff.

From time to time, the Bank appoint Assistants to the Governor to perform specialised assignments for the Bank, such as the training of local staff on central banking principles, setting up or organising new departments for the Bank and other services as required by the Bank. In the past the Bank had drawn heavily on seconded officers from the Reserve Bank of Australia, the Bank of England, and the Reserve Bank of India. Of late, the Bank obtained the services of two officers from the Deutsche Bundesbank, West Germany and the United States Federal Reserve System respectively, under the auspices of the International Monetary Fund Central Banking Service. Usually these officers serve for a term of two years or even shorter.

The Bank is organised into eight departments, mostly performing functions peculiar to central banking. There is also a system of five branches, each headed by a Manager. Each department or branch is divided into sections and sub-sections to facilitate administration and operation of functions. Appendix 'B' gives the general functions of each department or branch.

The discussion on any organisation is incomplete without discussing the staff that forms the organisation. It is to this that we now turn to complete the picture. We shall postpone the detailed discussion of the structure and functions of each department to a later section in this Chapter and in Chapter Three.

Bank Negara Malaysia Staff

Table 2-1 below shows the growth in the number of staff, since the official opening of the Bank in 1959. As can be seen the Bank has grown to quite a sizeable organisation in terms of personnel. From a meagre 46 at the end of 1958 (the Bank was unoffcially opened then), the total staff now is a bit more than 500. The increase in personnel over the last ten years reflect the growing activities of Central banking in Malaysia and with it the growing responsibilities of the young Bank Negara as the prime monetary institution in the country. From 1959 to 1960 there was a steady increase of recruitment at all levels to take account of the increase in the Bank's activities in the period. In 1960 part of the increase was due to the absorption of 20 staff from the Public Debt and Exchange Control offices of the Treasury, since the Bank at that time had taken charge of management of the public debt and exchange control from the Government. In 1962, only 7 persons were recruited and this was because the Bank had emphasised consolidation of present activities rather than expansion of new activities.

After 1963. recruitment at all levels picked up again in line with increased central banking activities in the country. By the end of 1964 there was a substantial increase in the Bank staff. Two reasons could be given for this. One reason was that the Singapore Branch which was opened towards the end of 1963 became a full-fledged branch entailing in more personnel to operate the branch. Another reason was that staff had to be engaged in anticipation for the extension of the Central Bank of Malaysia and the Banking Ordinances to the rest of Malaysia. Substantial increases were also noted in 1966 and 1967. The establishment of the Johore Bahru and Kota Kinabalu Branches in 1966 needed more staff. In 1967 the increase was the result of Bank's added function of currency issue. The establishment of the Currency Operations Department as the department to take charge of this important function meant more staff had to be taken in. Furthermore, the Kuching Branch was set up about this time also.

Table 2-I The growth of Bank Negara Malaysia Staff: 1958 - 1968

| End of Year | Total Staff | Net Annual Increase |
|---|---|---|
| 1958 | 46 | - |
| 1959 | 67 | + 21 |
| 1960 | 114 | + 47 |
| 1961 | 164 | + 50 |
| 1962 | 171 | + 7 |
| 1963 | 188 | + 17 |
| 1964 | 267 | + 79 |
| 1965 | 293 | + 26 |
| 1966 | 364 | + 71 |
| 1967 | 450 | + 86 |
| 1968 | 505 | + 55 |

Source: Bank Negara Malaysia Annual Reports: 1959 - 1968

The Bank's management has been very concerned about the training and development of staff at all levels so that the quality of central banking can be improved. Over the formative years of the Bank, the quality of the staff skill-wise, especially in the art of central banking, had been improving steadily; so much so that the remark made by the Governor in the first Annual Report of the Bank - "...... but for the most part the staff was completely untrained and unversed in banking practices" - has now become an understatement. Various methods of training are conducted by the Bank. Some of these are the following :-

i) On-the-spot training
ii) Encouragement of officers to pursue courses of study with recognised banking institutes such as the Institute of Bankers, London and the Bankers' Institute of Australasia. As an incentive bonuses are given on completion of such courses.
iii) Sending senior officers abroad for training courses at such international institutions as the international Monetary Fund, other central banks and to attend the SEANZA Central Banking Courses, sponsored alternately by member countries, and the International Summer Banking School.
iv) Residential Training course for clerical officers and executives.
v) Exchange programme of reseach staff with the Reserve Bank of Australia.
vi) Scholarships for staff to read economics at the University of Malaya and post-graduate studies at overseas universities.

More will be said about this later when we discuss the functions of the Establishment Department, which deals with staff matters.

For convenience of exposition, the eight departments are grouped into two categories, namely, a) Basic Administrative Departments, and b) Special Central Bank Departments.

By 'Basic Administrative Departments' is meant departments that are fundamental to any organisation, without which the structure of the organisation will be fragile and incomplete. In this category may be included the Bank's Establishment Department, Secretary's Department and Economic Research Department. The last is a borderline case, if the above definition is to be followed closely, but is included here merely for convenience again. These departments are discussed in this Chapter.

'Special Central Bank Departments' are defined as those departments of Bank Negara Malaysia that are peculiar to central banks only and are formed specially to carry out the objectives of the Central Bank as authorised by Parliament. In this category are included the Banking Department, Bank Supervision and Internal Audit Department, Accounting and Investments Department. Foreign Exchange and Exchange Control Department and Currency Operations Department. They will be discussed in Chapter Three.

## Structure and Functions of Basic Administrative Departments

### The Secretary's Department

The Secretary's Department may be regarded as the pivot of any organisation. Bank Negara Malaysia is no exception. It is the key department forming part of the Governor's Office. Its chief responsibility is to coordinate the wotk of other departments of the Bank and in carrying out this responsibility the Secretary acts on behalf of the Governor.

### Structure

The department is designed to execute its duties with a minimum of staff and a maximum of efficiency. The structured organisation of the department is shown in Appendix 'C'. As may be noticed the functional sections within the department are the Cable Section, the Registry Section, the Mail Section, the Secretarial Section, the General Section and the Security Section.

### Functions

The six main functions of the department are :

(i) To attend to matters pertaining to the Bank's Board of Directors.
(ii) To coordinate and facilitate action on interdepartmental matters.
(iii) To maintain the flow of communications.
(iv) To preserve the archival records of the Bank.
(v) To attend to relations with other organisations and the public.
(vi) To ensure adequate security in the Bank's operations and properties.

Work in connection with the Board of Directors includes the arrangement for Board meetings, preparation of agenda, compilation of Board papers and pre-Board briefings, recording of minutes of proceedings and policy records and attending to the appointment, leave, remuneration and allowances of directors.

The department despatches letters to branch managers every month informing them of developments in the Head office. Directives from Head Office are channelled through this department to be sent to other departments and branches of the Bank. Interdepartmental affairs are also handled by this department. Thus it performs as a coordinator for the organisation.

The department maintains the flow of communications of the Bank. Here incoming and outgoing mails, cables and telegrams are processed. The telephone exchange and other communications systems are kept here.

The department is also responsible for the safe-keeping and preservation of the Bank's archival records, photographs, display materials, including coin and specimen currency notes, and the Bank's acquisitions of valuable paintings.

Work in connection with external relations are listed hereunder :

(i) Conducted tour of the Bank premises for official visitors and guests.
(ii) Official Bank receptions, including Branch opening ceremonies and Bank's anniversay.
(iii) Relations with Government and quasi-Government bodies.
(iv) Distribution of Bank publications and Fortnightly Return of Assets and Liabilities.
(v) Opening accounts with other central banks.
(vi) Tabling of the Annual Reports in Parliament.
(vii) Notices for public holidays.

Security arrangements have been transferred from the Establishment Department in September, 1968, as it was felt that Security should come under the direct control of either the Governor or an officer such as the Secretary who has close contact with the Chief Executive.

Other services provided by the Secretary's Department are provision of official transportation, duplication and photo-copying, destruction of secret and top secret papers, daily float of press cuttings, circulation of periodicals and gazettes and the safe-keeping of the Common Seal and its register.

The department implements and propagates the use of Bahasa Malaysia in the Bank. To do this it handles translation work for the Bank, maintains a card index of economic, financial and banking terms and generally liaises with the Dewan Bahasa dan Pustaka.

Responsibilities of main officers of the Department

a) The Secretary

As the Head of the Department, the Secretary is responsible for the overall supervision and proper functioning of the department, in which he is assisted by the Assistant Secretary. He attends to Board affairs and coordinates the work of other departments on matters relating to the Board or arising from Board decisions. He keeps the Common Seal of the Bank and registers its use. He keeps branch managers of the Bank informed of developments by a regular newsletter, and circulates notes of all important decisions made at Staff Meetings of the Governor with Heads of Departments. He is responsible for welcoming official visitors and guests. He is directly concerned with the welfare and conditions of work of departmental staff, and is a member of the Bank's Appointments and Promotions Committee, Premises Committee, and Library Committee. Also he is responsible for all security matters relating to the Banks's operations and properties.

b) The Assistant Secretary

The Assistant Secretary stands in for the Secretary during the latter's absence, and assists the Secretary at all times. The Assistant Secretary maintains a general day-to-day supervision over all departmental staff with particular reference to delegation of duties and issuance of clear instructions based on assignments set by her or the Secretary. She also supervises the departmental equipment and machinery, and any petty cash accounts. In addition, the Assistant Secretary is responsible for Bahasa Malaysia/English translations and other work relating to implementation of the Bahasa Malaysia in the Bank.

c) Administrative Assistants

The two Administrative Assistants carry out their particular responsibilities while maintaining close supervision over all sections of the department and their daily functions. They maintain an effective working discipline in an atmosphere of cooperative effort, and follow up all tasks to ensure completion of assignments as fast as possible. They assist in the preparation of confidential staff reports by the Secretary.

d) Security Officer

The Security Officer reports to the Secretary and is answerable through the Secretary to the Governor. He supervises and reports on security aspects relating to the Bank's properties, communications, transportation and staff.

e) Registry Assistant.

The Registry Assistant looks after the filing system of the Department, and keeps a general register of every file in the Bank except for the Currency Office and the Public Debt Section. She maintains a record of file movements, keeps a 'k.i.v.' file, records all non-classified incoming official mail and (at the discretion of the Secretary or in his absence the Assistant Secretay) classified mail, and supervises the machine for destroying secret papers. She prepares the weekly Float File of important correspondence for internal circulation and supervises the despatch, transportation and conference room arrangements.

The work of junior officers of the department is not so important for our purpose. Nevertheless, their functions are implicitly mentioned in the foregoing analysis.

The Establishment Department

From elsewhere in this study, we know that the Department was formed in September, 1961 with an initial staff of eleven, comprising of one Manager, one Administrative Assistant, five Clerical Officers, two Junio Stenographers, one Typist and one Office Boy.

For the current set-up of the Department, refer to the organisational and functional chart in Appendix 'D'.

Functions

The department has four principal functions namely :

(i) Personnel Relations,
(ii) Personnel Services,
(iii) Training and Development,
(iv) Premises and Supplies.

The work is divided, not necessarily equally, between the two sections - Personnel Section and Premises and Supplies Section - within the department. Although the functions are thus sectionalised, all the sections are interdependent and officers may be required to serve, through rotation of duties, in all sections. Let us take the work in each Section in turn operationally and administratively.

Personnel Section

The primary functions of this section are to provide the Bank with sufficient personnel with the requisite experience and qualifications to meet the immediate and future needs, and to establish general conditions of service.

Personnel work covers a complex network of activities and practice covering many aspect of employer and employee relationships. In order to arrange these it is usual, particularly in larger organisation, for staff management to be based upon a formal staff policy for guidance and practice of management and staff alike.

The basic function of the section is to assist in the formulation and administration of Bank Negara Malaysia's overall staff policy. Owing to the range and complexity of this function, this section is engaged in a wide variety of activities. The personnel relations part deals with such functions as staff recruitment, transfers, training, staff reporting, promotion and classification, payment and revision of salaries and allowances. Personnel services include maintenance of staff records, medical treatment and hospitalisation, and transport and travel.

Initially, Bank Negara followed Government Service staff policy and practices quite closely. This is still reflected in the Bank's Staff Circulars and conditions of employment, and in references to Government General Orders and other conditions of service prevailing in Government service. However, the Bank has modified the procedure and practice where necessary to meet the Bank's particular needs and interests. Much of the work of this section therefore consists of examining both policy and procedure in the light of the changing structure and growing functions of Bank Negara Malaysia. This modification is reflected in the various Staff and Confidential Circulars, and other circulars issued by the Establishment Department.

<u>Staffing the Bank</u>

Since the provision for the right people for the right jobs in the Bank is a basic function of the Personnel Section, a detailed understanding is necessary of staff requirements against the individual facts of an officer's background, including his experience and capacity with a view to providing a more balanced staff. Heads of Departments are requested to submit at the end of the year their staff requirements for the coming year. These returns are compiled and scrutinised by the Establishment Department before a recruitment plan is submitted to the Governor for approval.

<u>Recruitment</u>

It is the Bank's policy that vacancies, as far as possible, be filled by serving officers, failing which staff are recruited from outside.

The selection of candidates for appointment and promotion is carried out in accordance with the decision of the Board of Directors shown below:

(a) For Supervisory officers and above, selection is made by Selection Committee made up of -

(i) Adviser (as Chairman),
(ii) Secretary,
(iii) Manager, Establishment Department, and
(iv) One of the following officers to be nominated by the Governor:

Manager, Banking Department,
Chief Economist,
Chief Inspector, Bank Inspection and Internal Audit Department,
Manager, Accounting and Investments Department.

(b) For other officers other than in (a) above, the Selection Committee should comprise -

(i) Manager, Establishment Department (as Chairman)
(ii) Secretary, and
(iii) One senior officer nominated by the Governor.

The procedure adopted in staff recruitment is standard for any organisation such as advertising for job, intercview, etc.

Staff may be recruited at various levels. In advertising appointments, the minimum academic and other qualifications, age, and experience required are usually stated. Recruitment is normally undertaken at the time when the various secondary and tertiary level examinations are announced. Clerical appointments normally requires proficiency in Mathematics and either Bahasa Malaysia or English.

For higher appointments, the Bank recruits graduates of recognised universities, preferably those who have studies Economics or Commerce; those with professional qualifications in Accountancy and Secretaryship are also considered favourably. Honours degree graduates are recruited as Administrative Assistants or Assistant Economists, while those with pass degrees are appointed Executive Cadets or Research Assistants. However, serving clerical officers may be promoted to Executive Cadets or Research Assistants. In the early years of the Bank, officers were recruited to fill certain classified positions such as Cashier or Examiner/Authorising Officer, primarily on the basis of experience rather than academic or professional qualifications. This was undertaken in order to enable the Bank to function immediately and efficiently with a core of experienced staff.

Yearly assessment of staff needs is based on the estimated increase of the Bank's activities and on staff turnover. The latter is derived from detailed staff turnover statistics which are reviewed periodically. A close watch is kept on the overall staff position to detect unusual deviations from normal requirements. For instance, the imminent opening of a branch or the absorption of new functions by the Bank may lead to a need for immediate recruitment of staff to give time for training before they assume their duties. For example, staff requirement for 1967 was particularly heavy as the Batu Tiga Currency Office and the Kuching Branch were both established in the early part of that year, and the Bank also commenced currency issuing operations in mid-year.

Promotion and Classification

One of the most important functions of the Personnel Relations Section is to administer the promotion and classification system. Clearly defined avenues for promoting staff are provided through a system of classification of staff into an orderly progression of positions of increasing responsibility and importance.

Normally, officers are promoted to fill vacancies in classified positions, and staff confidential reports are used in connection with these promotion exercises, together with other data. However, in order to provide incentive as well as recognition to officers with excellent service records in the Bank, an annual promotion review is conducted by the Appointments and Promotions Committee to recommend suitable staff for promotion to vacant positions, as well as higher grades in the same salary scale, e.g. from Grade III Clerical Officer to Grade II, Assistant Economist to Economist, and so on.

The classification system is kept under constant review by the Establishment Department in conjunction with the Appointments and Promotions Committee of which the Manager of this department is a member. Secretarial and administrative work for this committee is undertaken by the Administrative Assistant dealing with Personnel Relations.

The promotion and classification system in the Bank have been developed to ensure flexibility and the maximum of opportunities which will improve career prospects while meeting the Bank's actual (or, in some cases, anticipated) needs. These systems give an incentive to staff to maintain efficient performance over long periods so that career prospects in the Bank are enhanced. Every officer has the opportunity of reaching the highest post in the Bank's establishment.

## Other Functions of the Personnel Section.

These include administering staff transfers, slaries, allowances and fringe benefits including housing loans, vehicle loans and provident funds to name a few. Centralised records are maintained for all staff including personal and confidential files, service cards, and leave service cards. The Section has responsibility for the Bank's medical service, warrant tickets for air and rail travel, and accommodation and travelling arrangements (including insurance) for officers within Malaysia and overseas.

A constant watch is kept over conditions of service and this involves detailed understanding of staff problems and working conditions and their relation to conditions and problems outside the Bank. The views and requests of the Bank Negara Malaysia Staff Association (there is no union yet) are channelled through the Establishment Department for consideration by the Staff Committee comprising the Adviser as Chairman and two Bank management representatives appointed by the Governor, and two staff representatives appointed by the Staff Association.

## Training and Development

Bank Negara has organised courses for the staff at various levels, including General Training Courses and Executive Training Courses. When the first course was held, in the Bank's working premises, participants attended lectures during working hours. Later, courses were made residential. The Bank's practice had been (principally Bank staff but with a few places for commercial banks and, latterly for Treasy officers), and the other for Clerical Officers (solely for the Bank's staff).

The types of training encouraged by the management are generally those given in the section 'Bank Negara Staff' above.

The preparation of a a Bank Negara training course is undertaken by the Establishment Department working on the recommendations of a Training Committee comprising the Manager, Establishment Department as the Chairman and officers from selected departments as members. The syllabus for each training cource is reviewed annually by the Committee to bring it up to date with the latest developments in banking and related subjects. The preparation of the syllabus, time-table and selection of lecturers are made on the advice and recommendation of the Training Committee.

The Bank has acquired a site next to the Government Staff Training Centre in Petaling Jaya for the Bank Negara Staff Training Centre, which is expected to be completed in 1970. This centre will enable the Bank to broaden its range of courses very greatly, increase the intake of trainees, and offer more bank training facilities to the staff of outside institutions.

Premises and Supply Section

All the branches of the Bank should eventually be accommodated in permanent premises. One of the functions of this Section is to work to provide the Bank's administrative departments and branches throughout Malaysia with suitable accommodation for operations. The planning of Bank Negara buildings in Kuala Lumpur, Penang and Kota Kinabalu has been undertaken by architects working closely with this Section. The Section is also involved in the acquisition of suitable building sites, as in Ipoh, Johore Bahru and Malacca, and in overseeing the planning of staff accommodation in Kuching and Kota Kinabalu and the Staff Training Centre in Petaling Jaya. A Supervisory Architect heads this Section in view of the complex and technical aspects of the Section's principal duties.

To assist the Architect in preparing his building design, the Premises Section is responsible for assessing the Bank's future requirements over a set period of years. These are studied by the Premises Committee which then embodies its recommendations as approved by the Governor in briefs for the Architect. Special requirements for equipment, libraries, archives, vaults and other special areas also receive close study in the light of future needs, technological innovation, and modern trends in banking and Central Banking.

The Bank's Premises Committee, consisting of the Adviser (as Chairman), the Secretary, the Manager (Establishment Department) and the Supervisory Architect, considers proposals submitted by the Premises Section and submits its recommendations to the Governor for approval.

The Premises and Supplies Section is responsible for all maintenance of the Bank's buildings. The supplies side of it, as the name implies, is responsible for the purchasing, distribution and control of stationery, equipment, furniture and fittings and other supplies for the Bank.

Economic Research Department

One of the earliest departments to be formed in the Bank is the Economic Research Department. Initially, it was known simply as the 'Economic Department', the result of the efforts of a seconded officer from the Reserve Bank of Australia. Since then, it has become one of the most important departments in the organisation.

Functions

The principal fuction of the Economic Research Department is in the province of economic intelligence, research and advice - all of which are given on the basis of the constant research, processing and interpreting of the large amount of materials and data flowing into the department. Service is provided primarily for use of the Governor and the Board of Directors. The department also attempts to meet the needs of the Government and other organisations, public or private.

The purposes of economic analysis and the above functions are:

(i) to obtain information on the changing environment in which the Bank has to work and to forecast the future development of the situation;

(ii) to measure the effects of the Bank's actions and to formulate guides as to what its next action should be, if any,

Structure

Given the above purposes and functions, the Economic Research Department should be structured and organised in a manner which will help maximise its role of contribution. Unless properly organised, any entity will not be able to meet its needs for information and analysis comprehensively and expeditiously.

The previous structure of the department was characterised by the staff being divided into informal groups, each group specialising in broadly 4 distinct fields :-

(i) group on external economic conditions
(ii) group on balance of payments, national accounts, money supply and banking
(iii) group on public finance and development, and
(iv) group on primary products and domestic financial institutions.

The structure was rather weak, although needs were met, sometimes after some delay. Since the grouping was an informal one, it does not allow for specialisation. Members more often than not had to do ad hoc work as well. Clearly a reorganisation was called for. After some research on the set-up of economic research department of various central banks, a new structure was drawn up, culminating in the organisation chart found in Appendix 'E'. This chart was drawn up sometime in 1967. As illustrated, there are five divisions all designed to take into account types of functions which should appropriately be given emphasis.

Later, as new ideas came the department was again reorganised to take in new and added duties. This is shown in Appendix 'F'. This set-up is the current one for the department.

The department is divided into seven sections compared with five in the old one.

Probably the most important divisions is the 'Money and Banking' Division, as it bears directly to the principal function of Bank Negara Malaysia, that is, monetary policy and monetary management. The division will make a continuous study of how bank liquidity and money supply behave over time. The findings will enable the Bank to base its monetary policy and measures to be taken. The study will include monetary analysis, types of monetary policy, commercial banks activities and developments, interest rates, financial intermediaries, and capital and money markets.

The main function of the 'Public Finance' division is to keep abreast with fiscal policy and fiscal operations and to see how they affect money supply and bank and private liquidity. This division to work closely with the 'Money and Banking' Division. To enable the division to carry out this duty, the following have to be studies:

(a) Budgets and budget administration of Federal, State and local Governments,

(b) Intergovernmental financial relations between the Central, State and Local Governments,

(c) Public Expenditure - general and expenditure policy for Stabilisation and growth,

(d) Taxation and other revenue, and

(e) Public Debt and debt policy.

The main function of the 'Balance of Payments and National Accounts' Division is to compute Balance of Payments developments, which will throw light on the effects, if any, of balance of payments on the money supply. The following variables are analysed:

(a) Balance of Payments; (b) International Reserves; (c) Foreign Exchange, exchange control and the international monetary systems; (d) International capital movements; (e) Import/Export indices and terms of trade; (f) International trade organisations (GATT, etc.) and trade agreements; and (g) National income and expenditure and components of national product.

The Internal Division is responsible for the compilation of commodity statistics and compilation of employment, prices, wages and other economic indicators statistics. After these statistics are compiled, they are then analysed for close study.

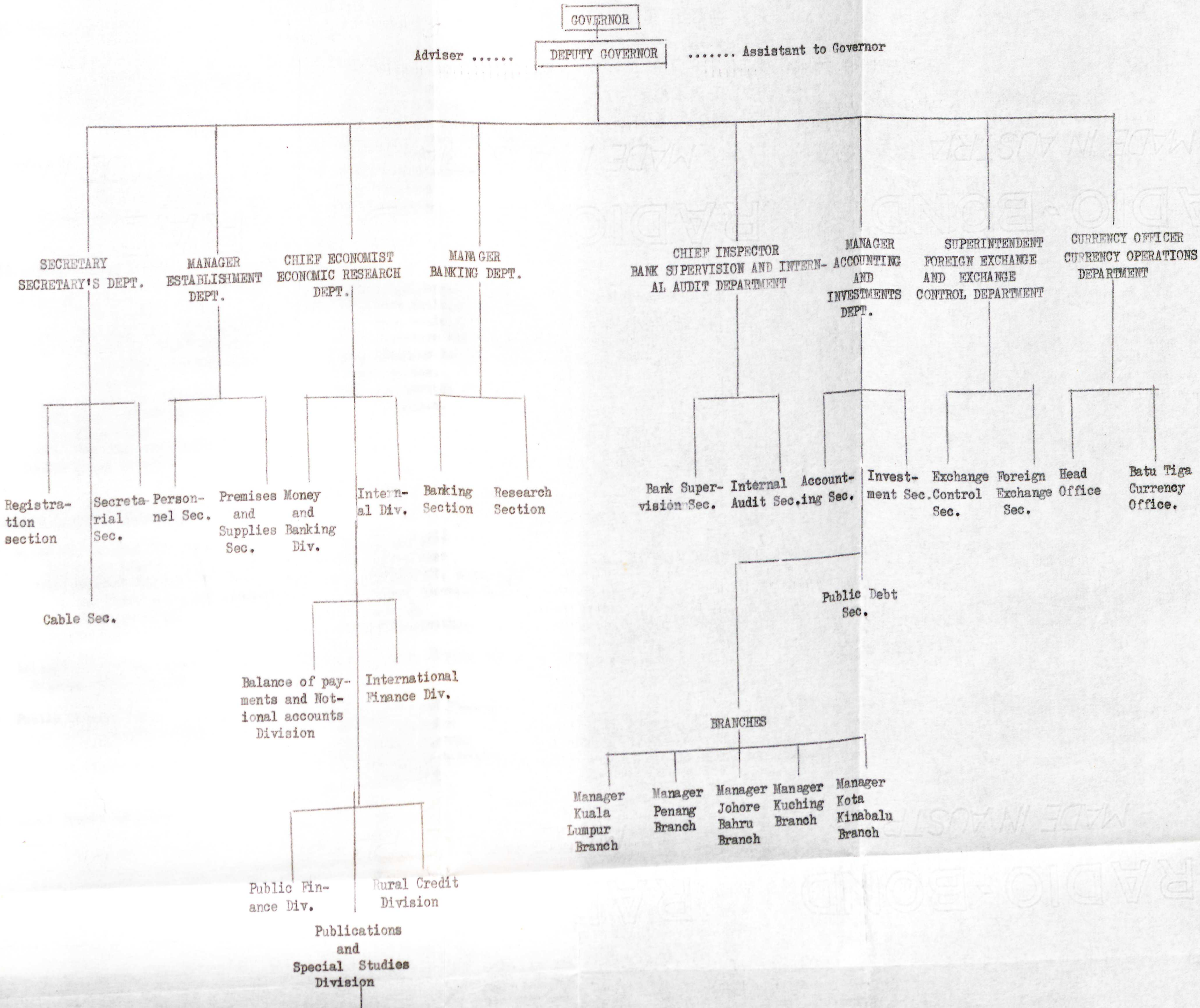
The developments in international finance are studied by the International Finance Division. In addition, international organisations like the International Monetary Fund, International Bank for Reconstruction and Development, Asian Development Bank and Economic Commission for Asia and the Far East and other institutions are kept in mind and studied.

The main concern of the Publications and Special Studies Division is in the preparation of the Bank's Annual Reports and Quarterly Economic Bulletins. It also entertains public demands for economic information and as such it prepares information booklets on money, banking, finance and other topics of interest. The Bank's library comes under the wings of this division.

As for the general administration of the department, the chief executive is the Chief Economist and he is assisted by a Deputy Chief Economist. Below these officers, there is a hierarchy of other officers such as Economists, Assistant Economists, Research Assistants and Clerical Officers.

APPENDIX "A"

ORGANISATIONAL CHART : BANK NEGARA MALAYSIA



Appendix "B"

## General Functions of Departments of Bank Negara Malaysia

### Secretary's Department

a) Registration Section
- (i) Incoming and Outgoing mail
- (ii) Despatches
- (iii) Registry of files

b) Secretarial Section
- (i) Arrangement for Board Meetings
- (ii) Translations
- (iii) External relations
- (iv) Common Seal and Register of Sealing
- (v) Communications
- (vi) Visitors
- (vii) Archives

c) Cable Section
- (i) Incoming and Outgoing Cables and Telegrams
- (ii) Coding and decoding

### Establishment Department

a) Personnel Section
- (i) Recruitment
- (ii) Training and Development
- (iii) Promotion, Termination, Retirement, Secondment & Transfers.
- (iv) Facilities for staff
- (v) Staff insurance
- (vi) Allowances
- (vii) Salaries and Gratuities
- (viii) Loans to staff

b) Premises and Supplies Section
- (i) Bank Building projects.
- (ii) Bank vehicles.
- (iii) Furniture and Equipment.
- (iv) Premises Insurance.
- (v) Supplies.
- (vi) Maintenance of Bank Premises.

### Economic Research Department

a) Money and Banking Division
- (i) Money supply.
- (ii) Capital Market:
  - a. Financial Intermediaries.
  - b. Securities.

b) Internal Division
- (i) Commodities
- (ii) Employment, wages and other economic indicators.
- (iii) Administration.

c) Balance of Payments and National Accounts Div.

d) International Finance Div.

e) Public Finance Div.

f) Publications and Special Studies Division
- (i) Annual Reports
- (ii) Quarterly Economic Bulletins.

g) Rural Credit Division

Library



..... 2/

Banking Department

a) Banking Section
   (i) Licensing of Banks
   (ii) Interpretation of Laws
   (iii) Finance Companies
   (iv) Prescribed corporations
   (v) Trustee corporation
   (vi) Capital requirements
   (vii) Reserves and Liquidity ratio
   (viii) Alterations in Constitution
   (ix) Sources and Utilization of Funds
   (x) Compilation and analysis of banking statistics
   (xi) Examination and approval of accounts of banks.

b) Research Section
   (i) Preparation of Banking Statistics
   (ii) Annual Report
   (iii) Articles on Banking

Bank Supervision and Internal Audit Department

a) Bank Supervision Section

   (i) Inspection of Comercial banks

b) Internal Audit Section

   (i) Auditing of Internal Departments and Branches.

Accounting and Investments Department

a) Accounting Section
   (i) Bank's accounts
   (ii) Branch Operations including Cheques supplies
   (iii) Transaction in Singapore dollars.
   (iv) Staff Provident Fund
   (v) Miscellaneous Funds
   (vi) Stock Exchange and Capital Issues Committee

b) Investments Section
   (i) Treasury Bills and Money market operations
   (ii) Malaysia Government Securities.
   (iii) Bank's Overseas Accounts
   (iv) Advisory Services on Investment
   (v) Statistical Data.

c) Public Debt Section

   (i) Advice to Treasury re Terms of Loans
   (ii) Floating, records and Administration of loans
   (iii) Redemption and conversion of loans.
   (iv) Interest payments.

d) Branches (Kuala Lumpur, Penang, Johore Bahru, Kuching and K.Kinabalu)

   (i) Accounts
   (ii) Cash Section
   (iii) Overseas Section
   (iv) Inter-bank transfers
   (v) Clearing House
   (vi) Public Debt Section
   (vii) Exchange Control Section (Except Kuala Lumpur Branch)
   (viii) Currency Section (except Kuala Lumpur Branch).

Foreign Exchange and Exchange Control Department

a) Exchange Control Section

(i) Processing of payments on current transactions
(ii) Investments by and loans from residents of non-Sterling Area Countries
(iii) Dealings in Gold

b) Foreign Exchange Section

(i) Foreign exchange dealings
(ii) Exchange rates

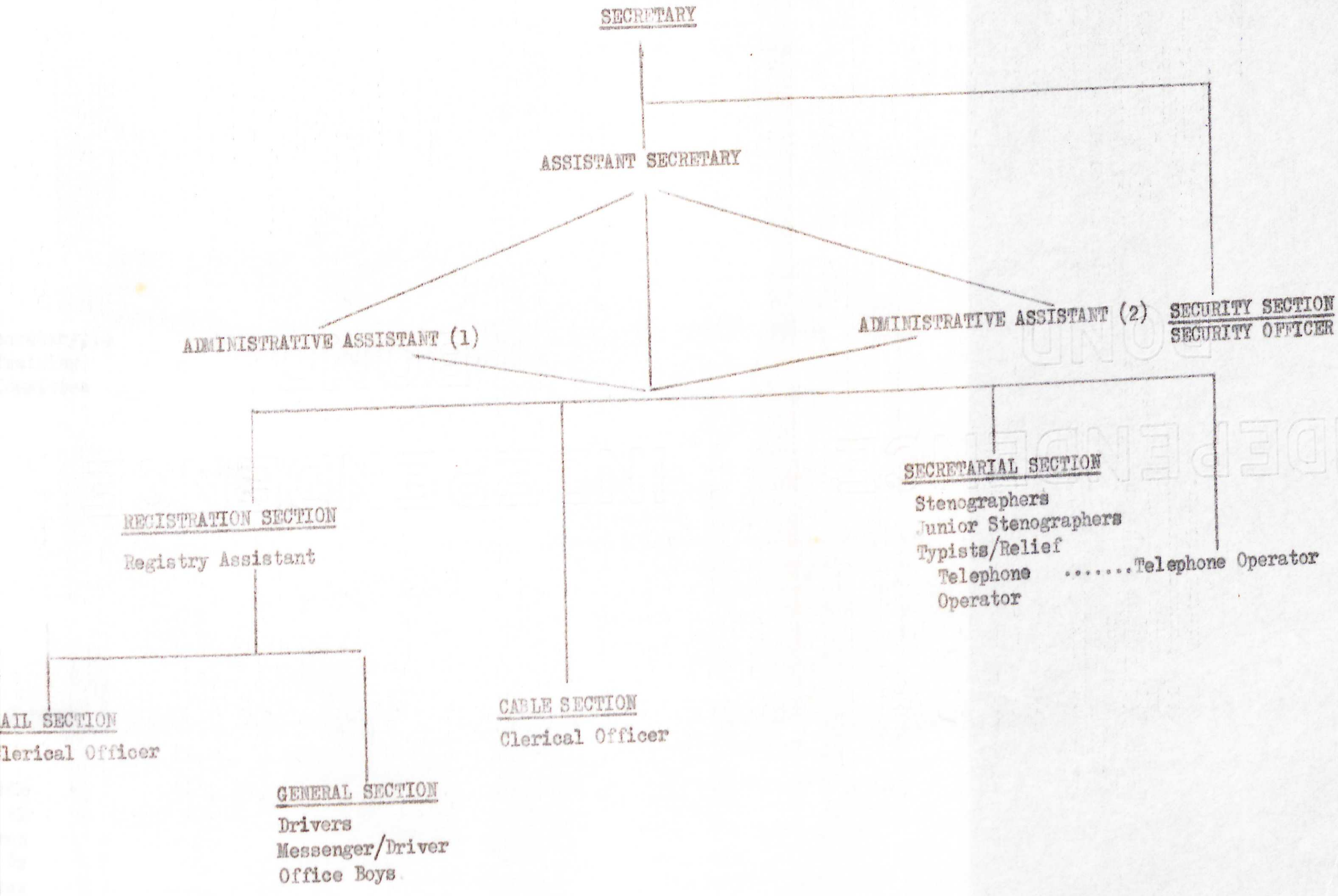
Currency Operations Department

a) Head Office
(i) Indent of notes and coins
(ii) Daily Currency operations
(iii) Currency escorts and Distributions.

b) Batu Tiga Currency Office
(i) Currency stocks
(ii) Supply of stock to Branches
(iii) Destructions of old Notes.

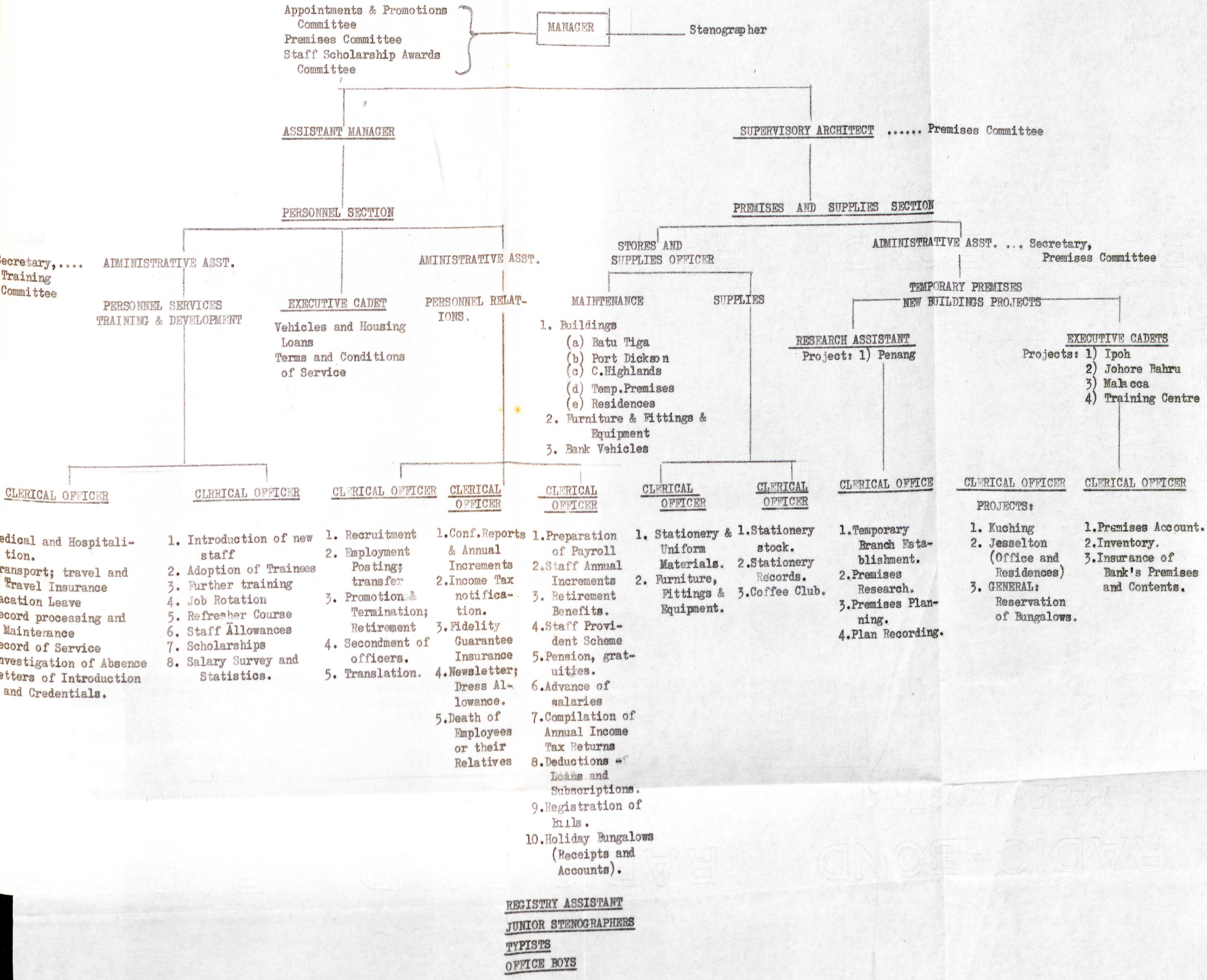
Appendix "C"

ORGANISATION CHART - SECRETARY'S DEPARTMENT



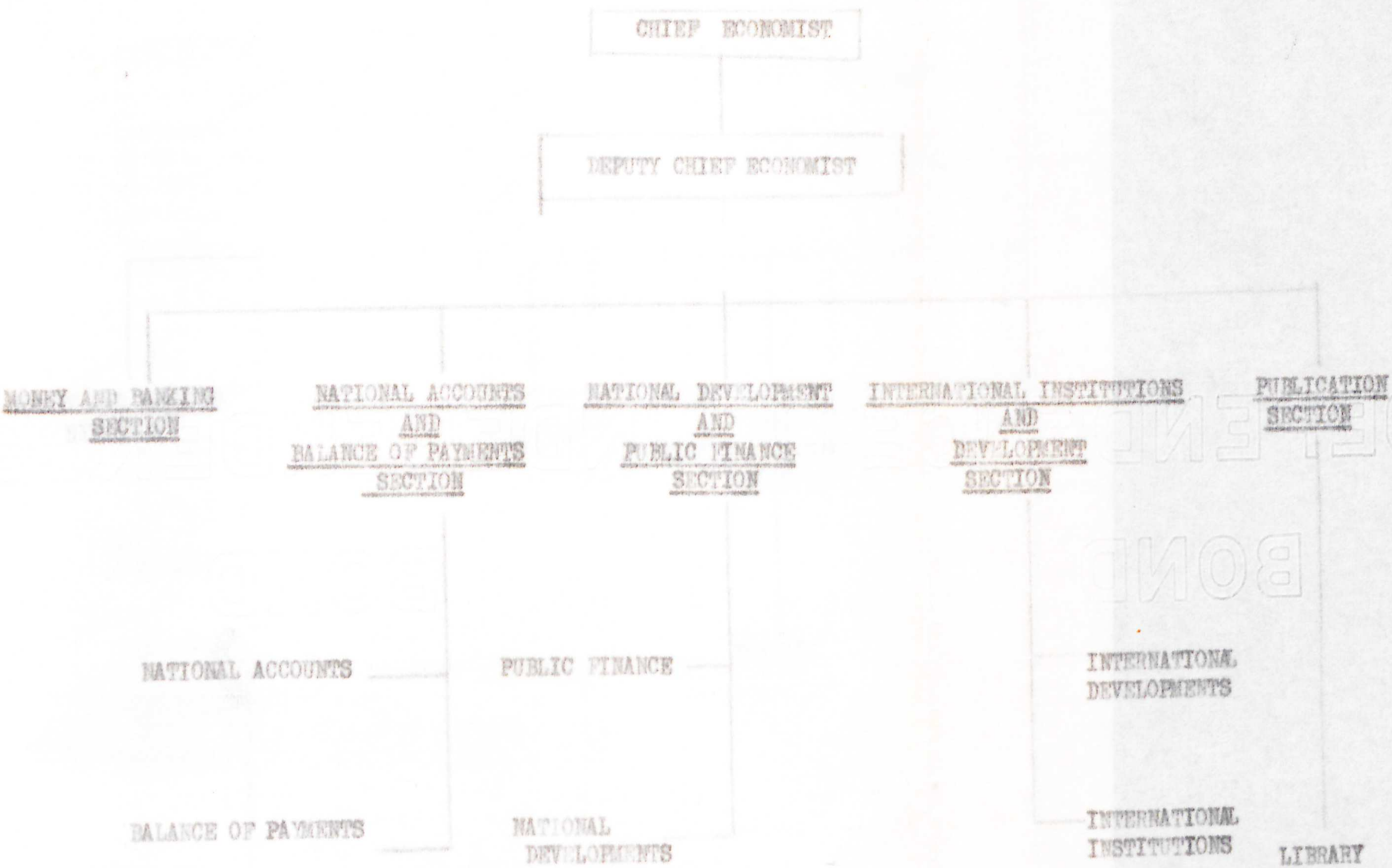
APPENDIX 'D'

ORGANISATIONAL AND FUNCTIONAL CHART - ESTABLISHMENT DEPARTMENT

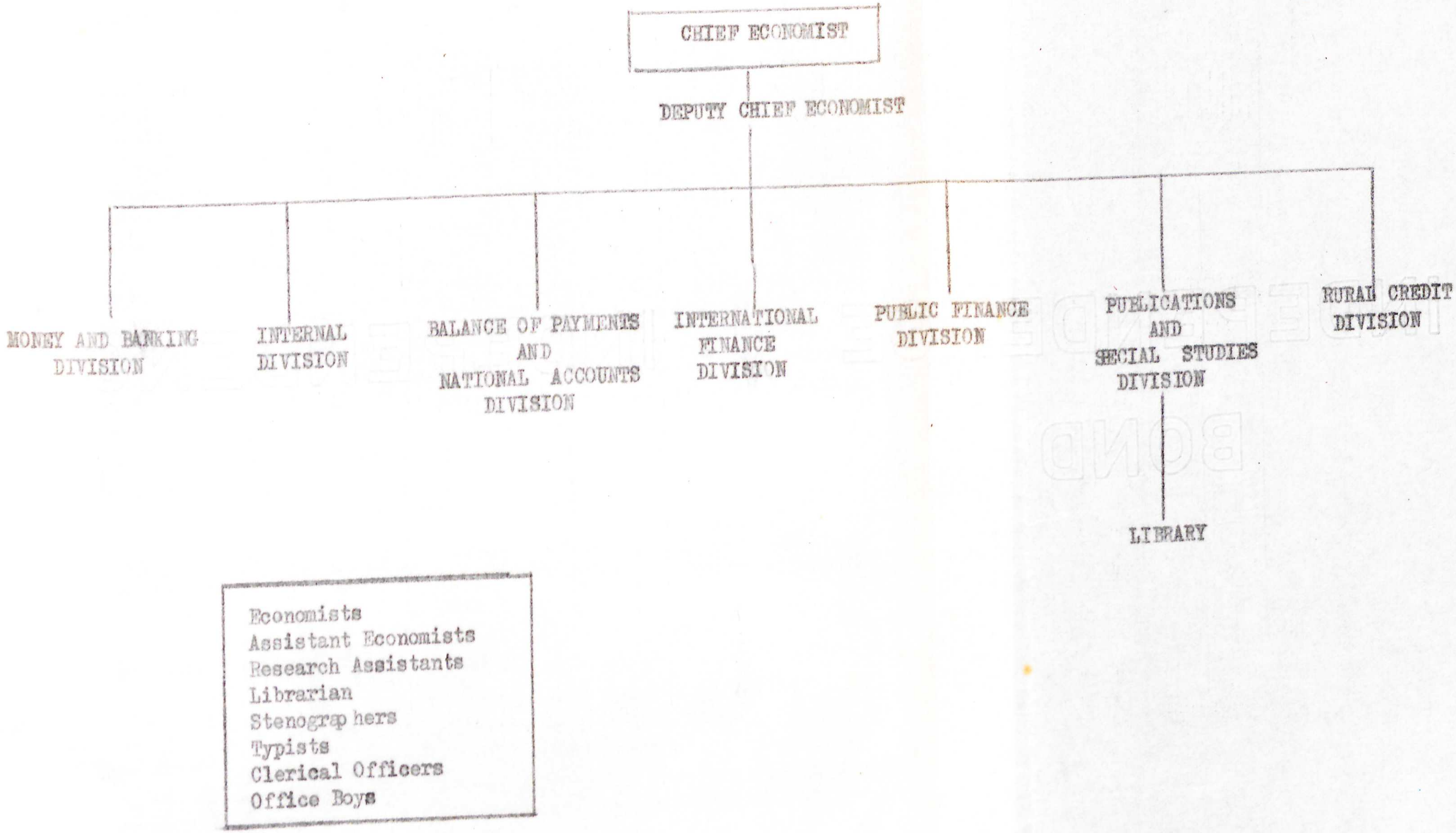


Appendix "E"

ORGANISATION CHART - ECONOMIC RESEARCH DEPARTMENT, 1967



ORGANISATION CHART - ECONOMIC RESEARCH DEPARTMENT, 1969



## CHAPTER III Structure and Functions of 'Special Central Bank Departments'

### Banking Department

Among the principal objectives of the Central Bank, as contained in the Central Bank of Malaysia Ordinance, 1958, are to promote monetary stability and a sound financial structure in the country; in particular, to influence the credit situation to the advantage of the Federation.[1] Towards these objectives, the Banking Department is set up principally to regulate broadly the activities of commercial banks. A good part of the work in the department is therefore taken up with, first, administration of the Banking Ordinance, the main instrument of control regulating the activities of commercial banks. Second, the work is taken up with relevant statutory provisions of the Central Bank of Malaysia Ordinance empowering the Central Bank to influence the monetary system through observance of liquidity standards, maintenance of statutory reserves, local assets ratio and prescription or recommendation of lending policy or interest rates.[2]

### Structure

The Organisation Chart of the department is shown in Appendix 'A' at the end of the Chapter. All the required information regarding the administration of the department can be obtained from here.

### Operation of Functions of the Department

For analytical purposes, the work in the department can be divided into four fields namely, (a) Administration of the Banking and Central Banking Ordinance; (b) Examination of annual reports of banks; (c) Analysis of banking statistics; (d) Borrowing companies and prescribed corporations; and (e) Research in relation to banks.

### Administration of the Banking and Central Banking Ordinance.

The provisions of the Banking Ordinance that frequently demand attention from the staff are the licensing of banks (Section 3), capital requirements (Section 4, 32 and 33), opening of branches (Section 4A), and alteration of constitution (Section 7). Banks wanting to open business in Malaysia have to apply through the Bank for a license and the department that processes these applications, right from preliminary enquiries stage to the final preparation of Board paper for subsequent approval or otherwise, is the Banking Department.[3] Sections 4, 32 and 33 of the Banking Ordinance require

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1 Section 4(c) and (d) of the Central Bank of Malaysia Ordinance, 1958.

2 Statutory powers have not been formally invoked, however, as the Central Bank relies on "moral suasion " to achieve these objectives.

3 Final approval, of course, lies in the Minister of Finance.

foreign banks operating in Malaysia to maintain net assets in the country (instead of approved assets in Malaysia as previously required) of not less than $2 million. The Banking Department keeps an up to date record of the net assets of such foreign banks. The Department also handles the applications from licensed banks in Malaysia to open branches in the country, or in the case of banks incoporated here wanting to open branches outside Malaysia. A written consent from the Central Bank is required before a branch is to be opened. Not infrequently, banks make amendments or alterations in Memorandum or Articles of Association, thereby requiring action under section 7(I). The department has to inform the Minister of Finance whether such amendments or alterations are in order.

The important provisions of the Central Banking Ordinance that are administered through the department are the liquidity requirements (section 36) and maintenance of reserves (section 37) The section on liquidity requirements of the Ordinance provides the Bank with a powerful weapon not only for control of credit but also for influencing the flow of funds to certain areas of finance,[4] while the section on the maintenance of reserves prescribes the amount of reserves to be held by each bank with Bank Negara Malaysia against its sigh and time liabilities in the country. This reserve requirment is also an important instrument of credit control.

In addition, Bank Negara Malaysia is empowered to approve modifications and exceptions to the form and content of the accounts of licensed banks; locally incorporated banks in respect of their global accounts, and foreign incorporated banks in respect of their Malaysian accounts; if not approved, banks required to comply with all provisions of the Ninth Schedule of Companies Act.

Examination of Annual Reports

Banks are required under section 9(I)(c) of the Banking Ordinance to submit each year a balance sheet and profit and loss account not later than six months after the close of the accounting year. The department makes a general survey of a particular bank's progress and special attention is paid to compliance with the various provisions of the Banking Ordinance such as; maintenance of Reserve Fund and recommendation for exemption where necessary (section 8); publication of balance sheet (section 9(I)(b); and appointment of auditors (recommendation for exemption in the case of foreign banks) (section 15).

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[4] Such as financing home ownership and government long-term expenditure. The present liquidity ratio requires banks to hold at least 50% of their Savings deposits in the form of longer-term government securities and housing loans.

Analysis of Banking Statistics

The following are the types of banking statistics received:-

(a) Monthly First Schedule - a statement of the Consolidated assets and liabilities of banks as at the close of business at the end of each month. (Also supplementary statistics three times per month, on the 8th, 15th and 22nd, as from June 12, 1957).

(b) Half-yearly Second Schedule - a statement giving an analysis of loans and advances and interest rates of banks as at the close of business on June 30, and December 31 each year.

(c) Yearly Fourth Schedule - a statement of the annual income and expenditure in respect of the Malaysian business of licensed banks.

(d) Data on Monetary Reserves - an annual statement required for the purpose of furnishing returns to the International Monetary Fund.

(e) Monthly statement of loans and advances to certain category of borrowers - a statement showing particulars of loans and advances, both secured and unsecured granted by a licensed bank to any of its directors; any firm in which it or any of its directors is interested as partner, manager of agent, or to any individual or firm of whom or of which or any of its directors is a guarantor; any of its subsidiary companies and to some other category of borrowers.

Work in connection with the preparation, compilation and analysis of these banking statistics are given in Appendix 'B' at the end of this Chapter.

Borrowing Companies and Prescribed Corporations

Banking Department has undertaken the administration of the Companies Act, 1965, as far as borrowing companies are concerned. An officer of the Department has been gazetted as Deputy Registrar of Companies. When the Borrowing Companies Act comes into force sometime in 1969, Bank Negara Malaysia is expected to assume responsibility for the administration of the Borrowing Companies Act,[5] and the Banking Department is expected to administer the Act. Up to now there is no word yet as to whether the Act has been in force or not.

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5 The principal object of the Act is to regulate and control the activities of borrowing companies, normally known as finance companies, for the purpose of protecting the interests of the depositors. "Borrowing Companies" are finance companies which accept deposits from the public, as opposed to finance companies which do not do so.

## Research

Occasionally studies are made on matters related to banking in order to gain a better knowledge of the banks and as a basis for formulating policies.

## Uses and Interpretation of Statistics

### First Schedule Statistics

The First Schedule statistics are used and interpreted by the department to study the trend of deposits and advances of commercial banks; to find out the sources and utilisation of funds, to obtain monthly calculation and adjustment of statutory reserves; and to work out advances ratio, liquidity ratio, local assets ratio and net assets position in Malaysia of foreign banks.

Apart from the fuction of administering the Banking and Central Banking Ordinances, the department keeps watch over the operations of individual banks, as well as the overall position of the banking position. A Board paper on the trend of deposits, advances, advances ratio, and liquidity position is submitted each month. In addition, as and when deemed necessary special features of banks are brought to the attention of the Board of Directors.

### Second Schedule Statistics

A breakdown of advances according to purpose enables the Central Bank to see the direction of back lending. Information relating to interest rate charged shows cost of borrowing to different sectors.

Board papers on advances and interest rates structure are prepared half-yearly.

## Interest Rate

As and when required, the interest rates structure appropriate to the economy is reviewed. Effects on movements of funds consequent upon changes in interest rate, prevailing credit situation, and other related variables are factors to be considered when making recommendations.

## ORGANISATION CHART OF BANKING DEPARTMENT

APPENDIX "A"

### M A N A G E R

(Overall Supervision of Department) ........... 

**Research Section**

Administrative Assistant )
Research Assistant )

1. Research
2. Preparation of Banking Statistics for Publication
3. Annual Report
4. Articles on Banking
5. Papers on banking for outside Organisation.

### Assistant Manager
(Assists Manager)

#### dministrative Assistant (A)

- Licensing of Banks
- Application for branches
- Approval of directors of banks
- Finance Companies
- Interest Rates
- Board Papers
- General Correspondence

#### Administrative Assistant (B)

1. Interpretation of Laws
2. Finance Companies
3. Prescribed Corporations
4. Trustee Corporations
5. Applications for Branches
6. Board Papers
7. General Correspondence

#### Administrative Assistant (C)

1. Capital Requirements
2. Alterations to Constitutions
3. Sources and Utilisation of Funds
4. Data on Monetary Reserves
5. Liquidity Ratio
6. Board Papers
7. General Correspondence

#### Executive Cadet (A)

1. Checking of 1st Schedule Returns
2. Checking of Supplementary Banking Statistics
3. Statutory Reserve
4. Unsecured Advances
5. Analysis of Malaysian Banking Statistics
6. Board Papers
7. General Correspondence

#### Executive Cadet (B)

1. Checking of 2nd Schedule Returns
2. Checking of 4th Schedule Returns
3. Examination into Annual Reports of Banks
4. Analysis into Singapore Banking Statistics
5. Record of Individual Bank's Statistics
6. Record of Opening of Branches
7. Board Papers
8. General Correspondence

#### Executive Cadet (C)

1. Examination into Annual Reports of Banks
2. Approval of Accounts of Banks
3. Analysis of Returns of Branches outside Malaysiaby Malaysian Incoporated Banks
4. Record of Bamk's compliance with Barking Ordinance
5. Board Papers
6. General Correspondence

#### Stenographers and Typists (4)

Shorthand and typing work

#### Clerks (7)

1. Compilation of various statistics and statistical tables :-

   (a) First Schedule Statistics
   (b) Second Schedule Statistics
   (c) Fourth Schedule Statistics
   (d) Statistics of Monetary Reserves
   (e) Interest Rates
   (f) Supplementary Banking Statistics

2. Transposition of statistical data into Ledger.

#### Office Boy

1. Despatch work
2. Prepare coffee

## WORK IN CONNECTION WITH BANKING DEPARTMENT

### I. First Schedule

(1) Checking of individual returns as they are submitted.

(2) Calculation of statutory reserve requirements for the month for immediate action.

(3) Preparation of the following statistics :-

(a) Deposits by type and customers
(b) Deposits and advances by States
(c) Advances ratio
(d) Liquidity ratio
(e) Local assets ratio
(f) Unutilized overdraft limits, number of current deposit and overdraft accounts (half-yearly).

(4) The above statistics are :-

(a) Compiled into tables.

Special tables are :-

(i) Local assets of individual banks.
(ii) Deposits by type and customers.
(iii) Position of individual banks.
(iv) Net overseas assets/balances of commercial banks.
(v) Sources and utilisation of funds of individual banks.

(b) Transposed into appropriate ledgers.

(5) Preparation of Board Paper tables :-

In all, three separate tables and a graph are prepared monthly.

(6) Calculation of annual averages of various statistics listed in (3) above.

(7) Preparation of Singapore banking statistics derived from Singapore First Schedules for Board Paper.

### II. Second Schedule

Advances

(1) Checking of Second Schedule.
(2) Compilation of all bank advances by purpose and by size.
(3) Preparation of tables for Board Meeting.
(4) Transposition of statistics into ledger.

Interest Rates

(1) Computation of interest rates :-

(a) for sub-total classification.
(b) all bank aggregate.

(2) Preparation of table for Board Meeting.

III. Fourth Schedule

(1) Compilation of early Fourth Schedule statistics in the form of statement of income and expenditure of banks in respect of their business in Malaysia.

(2) Compilation of data for national income and balance of payments statistics of the banking sector.

IV. In addition, this Department compiles and supplies statistics for the following purpose :-

(1) Bank Negara Malaysia Annual Reports.
(2) International Monetary Fund.
(3) Federation Year Book.
(4) Colombo Plan Country Chapter.
(5) Monthly Statistical Bulletin of Malaysia.
(6) Quarterly Economic Bulletins.
(7) Miscellaneous.

Sources : Jabatan Bank, Bank Negara Malaysia

## Bank Supervision and Internal Audit Department

### Introduction

Section 35 of the Central Bank of Malaysia Ordinance, 1958, provides that Bank Negara Malaysia shall use its best endeavours in co-operation with other banks in Malaysia to promote and maintain banking services for the public; and to foster high standards of banking in Malaysia.

Towards these objectives, which are aimed at ensuring that sound banking practice and good management are maintained by banks in Malaysia so that the public interest may be protected and the needs of the community are adequately served, the Bank Supervision Section was set up to investigate under conditions of secrecy, the books, accounts and transactions of each licensed bank and of any branch, agency or office in or outside Malaysia opened by a licensed bank incorporated in Malaysia. The power to investigate banks, from time to time, is laid down in Section 16 of the Banking Ordinance, 1958, although for special investigation of banks as may be directed by the Minister of Finance, authority to do so is vested in Section 17 of the same Ordinance.

### Organisation and Present Structure

The Bank Supervision Section was set up in 1959 with the assistance of two officers seconded from the Reserve Bank of India, as mentioned in Chapter Two. Beginning with a small staff under training, the section gradually enlarged as the nature and volume of inspection work increased consequent upon the opening of new banks and the opening of more branch offices.

For some time, the section remained an integral part of the Banking Department until April, 1964 when it became a separate department known as the "Bank Supervision Department". About a year later, internal audit was added to the functions of the department and the name was changed to "Bank Supervision and Internal Audit Department". The present structure of the department consists of one Chief Inspector, one Deputy Chief Inspector [6], one Inspector, one Assistant Inspector, seven Administrative Assistants, eight Executive Cadets, seven Clerical Officers, two Stenographers and two typists.

### Functions of Bank Supervision

Bank supervision covers a wide range of technical functions relating to banking operations which include, inter alia, the following :-

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6 This post is vacant at the time of writing.

(i) The issurance and enforcement of supervisory and other regulations.

(ii) The scrutiny and appraisal of applications received for new banking licence or establishment of branches.

(iii) The periodic examination of banks and the giving of advice to their management for correcting unsatisfactory or unsound conditions found through such examination.

(iv) The reviewand analysis of periodic reports on the state of affairs of examined banks.

(v) The rendering of counsel and advice on operating problems upon the requeat of banks.

(vi) The approval of proposed changes in the scope of bank's functions and their capital structures.

(vii) The approval of bank's constitutional changes such as amalgamation, reconstruction or other arrangement.

(viii) The supervision of bank's voluntary or enforced liquidation, and

(ix) Any other bank supervisory functions which come within the purview of the Banking Ordinance as well as the Central Bank of Malaysia Ordinance.

Some of these functions such as (iii), (iv) and (v) above are carried out by the Bank Supervision and Internal Audit Department, while the rest of them are being effected by the Banking Department. As such a more appropriate name for the Department would be perhaps, "Bank Inspection (or Examination) and internal Audit Department".

Techniques of Bank Inspection [7]

Before discussing the techniques of bank inspection, it is important to note that an inspection of a bank does not generally include an audit of it. An inspection concerns itself primarily with appraisal while an audit concerns itself primarily with verification. While an inspection is not an audit, it does not follow auditing methods and procedures in proceeding through a systematic review of balance sheet items.

The technique to be employed in every inspection is to verify and appraise all assets; to verify liability accounts as shown in the books; to check on the observance of banking laws, rules and regulation; to appraise the qualification of directors and the competence of officers; to appraise overall operations and to observe trends.

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7 For a good account of the purposes and methods of Bank supervision and inspection, see 'Bank Supervision and Inspection: Purposes and Methods', a paper prepared by Mr. Y. Huq in The Sixth SEANZA Central Banking Course, Vol.I (mimeographed), State Bank of Pakistan.

Bearing in mind that the element of surprise should always be maintained in conducting bank inspections, and inspection usually begins in the morning with a physical cash count made in the presence of the bank's Manager, Accountant and Chief Cashier. When this completed, the trial balance as of a certain date is verified with the General Ledger and subsidiary ledgers for correctness. After that, other items which require examination are carried out and these are briefly described below :-

(i) Assets

(a) Balances held with other Banks

Enquiry is made into the nature and purpose of these accounts and whether any interest is receivable on the balances. Verification is made with certificates of balances and reconciliation statements.

(b) Money at Call

Verification is made on the amounts held with other banks and the terms of these temporary loans.

(c) Loans and Advances

Examinations of the loans and advances portfolio constitutes the most important part of bank inspection work. Special attention is therefore directed to the types of loans and advances granted, the approving authority, credit information on the means and standing of borrowers and/or guarantors, limits sanctioned and the extent of total advances, the nature and value of securities accepted as cover for advances and a host of other related matters.

Documents such as title deeds, etc. are closely examined; statistics are collected and analysed; and inoperative/irregular advances accounts are listed for "special mention" or classified as "substandard", "doubtful" or "bad". If necessary, follow-up operations are instituted in order to keep a close watch on the progress made in regularising such accounts.

(d) Investments

This concerns the bank's own investments and examination is made into the portfolio, amount of each type of investment and the bank's investment policy.

(e) Properties

Examination is made into the bank's movable immovable properties, their valuation and adequacy of provisions for depreciation, insurance cover, etc.

(f) Other Assets

This item comprises s ch accounts as stationery, postages, accrued income, prepaid expenses, suspence accounts, preliminary and organisational expenses, etc. Examination is made into objectionable features such as unauthorised advances to bank's officers, directors and others through suspense accounts, payment of large share-selling commission to directors, executives, etc.

(2) Liabilities

(a) Paid-up Capital

The important points to note are the bank's capital structure in relation to Sections 4 and 32 of the Banking Ordinance, 1958 voting rights of shareholders and the ratio of paid-up capital and reserves and total deposits.

(b) Reserves

A study is made on the growth of the general reserves, secret reserves, and the bank's compliance with the requirements of Section 8 of the Banking Ordinance.

(c) Deposits

A note is made on the proportion of demand and time deposits to total deposits, rates of interest and fluctuations in the total volume of deposits over a period. Attention is paid to the practice of 'window-dressing'.

(d) Amounts due to/due from Head Office/Branches

These refer to inter-branch accounts outside Malaysia only. Examination is made into the nature and purposes of the accounts, size of the balances and rate of interest payable or receivable, if any.

(e) Amounts Borrowed

A note is made on the arragements with other banks, frequency, extent and purposes of borrowings and rates of interest payable.

(f) Bills Payable

A check is made on long outstanding items such as Sundry Creditors, Pension or Provent Funds, Income earned but not collected, e tc. A check is made on any irregularities and long-outstanding items.

(g) Profit and Loss

This item appears on the 'Liabilities' side when there is a profit and on the 'Assets' side when there is a loss. The account is examined to see whether there is any gain or loss arising from other than normal banking business such as sale of revaluation of investments, premises, immovable properties or other assets. A check is made as to whether there is any deferment in the charging of large expenditure incurred, or depreciation not taken into account, or bad and doubtful debts not provided for.

Other Observations

Other observations made in the course of inspecting are briefly as follows :-

(a) History and progress of the bank :

(i) Date of incorporation and founders.
(ii) Important developments in the management.
(iii) Branch expansion.
(iv) Financial and operational progress made.

(b) Management, Organisation and Administration -

(i) Composition of the directors and any significant changes in recent years.
(ii) Management and control exercised by, and powers of, the directors.
(iii) Meetings of the Board of Directos and general meetings of the bank's shareholders.
(iv) Powers vested in the chief executive officer of the bank and assessment of his ability and performance.
(v) Control and supervision of branches and internal audit arrangements.
(vi) Accounting system and maintenance of books of accounts and other records.

(c) Observance of legal and administrative requirements -

(i) The Banking and the Central Bank of Malaysia Ordinances, 1958 and regulations issued from time to time by Bank Negara Malaysia such as the maintenance of minimum liquidity ratio.

(ii) Rules of the Association of Banks in Malaysia.

(iii) Exchange Control Ordinance, 1953 and Notices issued thereunder.

(iv) The Stamp Ordinance, 1949.

(v) Law relating to and practice of banking.

(d) General assessment and appraisal of the bank's position.

An accurate appraisal is given of the bank's overall true position based on the information gathered from the books of account and other sources, and a correct presentation is made of important facts with apt comments and criticisms.

Upon completion of the examination, all matters requiring further clarification or corrective action are reviewed with the Manager of other senior executives of the bank concerned. A report of inspection is then prepared in which the inspecting officer-in-charge sets all the facts pertaining to the condition of the bank inspected as well as his appraisal of these facts.

Internal Audit

Internal audit consitutes an integral part of the functions of any large organisation, which has a complex of departments or a network of branches. In Bank Negara Malaysia, internal audit is instituted as a means of detecting errors and fraud and verifying whether the rules and regulations of the Bank are faithfully observed and whether the system introduced into each department is sound and adequate.

Although the accounts of Bank Negara Malaysia are being audited by the Auditor-General's Department, it has been found necessary to have an internal audit section to carry out such functions as conducting durprise checks, examinig the Bank's security arrangements, scrutinising the purchases of stationery, furniture and office equipments and carrying out other verifications which are outside the normal schedule of the Government auditors. Inevitably, there is an overlapping of functions being performed by the external and internal auditors. Certain adjustments in the schedules of both parties have, therefore, to be made in the light of experience.

Prior to the assumption of currency issuing powers of the Bank on June, 1967, only certain departments and all the branches of the Bank were subject to periodical internal audits. Since then, the list has been extended to include the Batu Tiga Currency Office on a permanent basis and other currency sub-centres and agencies on a temporary basis, before they cease operation.

## Accounting and Investment Department

### Introduction.

The next 'Special Central Bank Department' to be discussed is the Accounting and Investments Department. The head of the department is the Manager, and as such he is responsible for implementing all policies affecting his department orginating at Board level and communicated to him through the Governor, Deputy Governor or Adviser.

Like any other departments in the Bank, this department carries out certain specific functions and maintains close contact with other departments and organisations, both within and outside the Bank.

To facilitate exposition, the discussion of the functions and activities of the Accounting and Investments Department is divided into the following headings :-

(i) Relationship with other organisations and departments.

(ii) Structure of the Department.

(iii) Specific Functions of the Department.

### Relationships with other Organisations and Departments

The department keeps in close touch with certain departments within the Bank as well as other departments outside the Bank. This relationship may classified into two categories: external (relationship with outside organisations, and internal, (relationship with other departments and branches of the Bank).

(a) EXTERNAL

| Liaison with | | On Matters relating to |
|---|---|---|
| Auditor-General | - | the audit of the Bank's accounts and the accounts of the various funds for which the Bank acts as Treasurer. |
| Treasury | - | investment policies of the Government and implementation; loan raising policy, both domestic and foreign, and implementation; and matters connected with the principal objects of the Bank. |
| Accountant-General | - | Treasury bill operations, redemption of Government securities, Public Debt management, Exchange Control and Public Debt expenditure; |
| | | overseas investment arrangements. |

| | | |
|---|---|---|
| Stock Exchange | - | new issues, protection of investors, riles and by-laws of the Stock Exchange. |
| Short-term Money Market | - | investment opportunities, promotion of bill and securities market, lender of last resort facilities, safe custody facilities. |
| National Funds | - | e.g. National Defence Fund, National Disaster Relief Fund, National Patriotic Fund, arising from the Bank acting as banker and treasurer. |
| Commercial Banks | - | the department acts as custodian for a number of commercial banks for safe-keeping of certificates deposited by them under the requirements of the Banking Ordinance. |
| Overseas Banks | - | facilities for keeping of current accounts and the drawing upon them; these overseas banks also collect bills sent to them by the Central Bank. |
| International Financial Institutions | - | Both the IMF and the IBRD (World Bank) maintain current accounts with the Central Bank which acts as depository for these organisations. |

(b) INTERNAL

As one of the chief operational departments of the Bank, close ties as summarised below are maintained with other departments of the Bank :-

| Liaison with | | On Matters relating to |
|---|---|---|
| Secretary's Department | - | the receipt and transmission of telegraphic advices and payments; receipt and despatch of mail. |
| Currency Operations Department | - | statistics of currency operations. |
| Foreign Exchange and Exchange Control Department | - | foreign exchange transactions affecting accounts held overseas. The exchange rates at which foreign currency is to be converted is supplied by this department to the Accounting and Investments Department. |

Branches of the Bank - the Accounting and Investments Department control all branch operations. More will be said later.

Establishment Department - staff salaries, housing and vehicles loans, claims and deductions, payment and checking bills, staff allowances, etc. The Establishment Department also advises the Accounting and Investments Department of any resignations, new appointments, promotions, etc. so that proper action can be taken.

## Structure of the Accounting and Investments Department

The executive of the department is the Manager, who is responsible for the administration of the department as a whole. All communications to higher authorities are normally channelled through him. He is assisted in the discharge of his duties by the Assistant Manager.

For administrative convenience, the technical functions of the department have been grouped into three major sections, each section being headed by an administrative Assistant. A brief description of the major duties under each section is given below :-

### Accounts Section

This section deals mainly with items like payments of bills, the accounts of the Bank, the preparation of fortnightly assets and liabilities, final and interim accounts, the Stock and public issues, and Malayan Muslim Pilgrims Savings Corporation.

### Treasury Bills and Government Securities Section

This section deals mainly with treasury bills operations, buying and selling of Government securities, branch operations, cheque printing, purchases and sales of Singapore dollars, and miscellaneous funds.

### Overseas Investments Section

This section deals mainly with overseas investments, purchases of gold, purchases of foreign securities, placement of time deposits, statistics and graphic presentation of statistics.

All communications through the Manager as regards the operation of each particular section are channelled through the Administrative

Assistants to the Assistant Manager. The principal function of the Administrative Assistant is to maintain a control of the sections for which they are in charge. Appendix 'C' outlines the main responsibilities of officers in the department only.

The Manager is also one of the trustees appointed by the Bank for the Staff Provident Fund, and the administration of this Fund is one of the duties of the department. Reference to Appendix 'C' will show the general structure of the department.

Specific Functions of the Accounting and Investments Department

(i) Payments of Bills

All bills for expenditure incurred by the Bank are sent to this department for payment. Bills are generally of two classes - those of a routine type, payment of which are charged against revenue for the year, and those related to the acquisition of capital assets. The latter class usually consists of purchases of land and improvements thereto.

Bills are paid after they have been certified by the Department transmitting it and scrutinised by the Accounting and Investments Department. Bills for payment incurred by all departments of the Bank are sent to the Accounting and Investments Department for payment.

(ii) Overseas Accounts

The department maintains NOSTRO accounts,[8] that is overseas accounts opened by Bank Negara Malaysia to service the requirements of both the Government and for its own purposes. By tradition, accounts are opened mainly with the overseas central banks but this does not always follow. Entries affecting these overseas balances of the Bank are posted in the Nostro Ledger kept by the Department. Frequent reconcilliations between these records and the statements submitted by the overseas banks are made to ensure that all transactions are accounted for. Daily balances of Accounts are supplied to the Foreign Exchange and Exchange Department and to the Overseas Section of the Kuala Lumpur Branch, which are thus kept informed of the state of the balances.

(iii) Branch Operations

All the operations of the Branches of the Bank are under the direct supervision of this department. First, this department undertakes all preliminary work regarding the opening of a Branch of Bank Negara, for example, the accounts to be opened, operational instructions, authorised signatories, key-holders of strong-rooms, printing of cheques, overseas account and the like.

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8 In this connection, there are also VOSTRO accounts, that is, accounts opened by foreign central banks and international financial institutions like the IMF and IBRD with Bank Negara Malaysia.

All Branches, once in operation, send the daily operational statements and Balance of assets and liabilities. At fortnightly intervals, detailed balance sheets are forwarded and these are consolidated. The Bank publishes its Fortnightly Statement of Assets and Liabilities. A speciment is shown below:

Specimen

Fortnightly Statement of Assets and Liabilities
(pursuant to Section 47: Central Bank of
Malaysia Ordinance, 1958)

The return of liabilities and assets by Bank Negara Malaysia

at the close of business on August 15, 1969 shows the following :-

| | | |
|---|---|---|
| **Liabilities** | | |
| Capital | | $ 20,000,000 |
| General Reserve Fund | | 31,939,456 |
| Malaysian Currency in Circulation | | 924,116,594 |
| Deposits: | | |
| Banks | $155,205,891 | |
| Malaysian Government | 491,373,759 | |
| Other deposits | 211,837,744 | 858,417,394 |
| Bills Payable and other Liabilities | | 52,728,583 |
| | | $1,887,202,027 |

| | |
|---|---|
| **Assets** | |
| Gold and Foreign Exchange | $1,682,294,309 |
| Malaysian Government Securities | 133,842,231 |
| Bills Receivable and Other assets | 71,065,487 |
| | $1,887,202,027 |

Cheques are printed for the Branches by the Head Office. All expenditure incurred by the Branch is scrutinised by the department to ensure that the expenditure incurred is reasonable and in accordance with instructions.

(iv) National Funds

The Bank is frequently called upon to act as treasurer to the various Funds launched by the Government, for example the National Defence Fund, the National Disaster Relief Fund and the National Emergency Relief Fund, the last the most recent one. The responsibility to maintain full records of all collections and expenditure on behalf of the Funds falls within the province of the Accounting and Investments Department.

(v) Treasury Bills

The Treasury Bill is essentially a form of short-term borrowing by the Government. All Bills are issued in units of $10,000. Until February, 1964, the issue was done by the Accountant-General's Office, but since then the Bank has taken over complete responsibility for its management.

Treasury Bills are issued for period of 3, 6, 9 or 12 months, in any case, not longer than one year. The discount rate is fixed by the Minister of Finance, and is currently as in the following Table 3-I.

Table 3-I Malaysian Government Treasury Bills Discount Rate as at July, 1969.

| | | |
|---|---|---|
| 91 days (3 months) | ... | 4% |
| 182 days (6 months) | ... | 4½% |
| 273 days (9 months) | ... | 5% |
| 364 days (1 year ) | ... | 5½% |

Unlike fixed deposits with any commercial bank where the full principal is to be deposited, the buyer of a Treasury Bill pays only the net price, that is, the difference between the full amount and the discount. Thus, a Treasury Bill for $10,000 for one year at 5½% interest per annum will cost the buyer only $9,450. The Treasury Bill rate was increased to 5½% per annum in November, 1967 after the sterling devaluation, but was reduced to 4½% per annum in June 1968 and to 4% from August 1, 1968. The June, 1968 adjustment was "aimed at meeting an inflow of funds arising from international monetary uncertainties which were causing a sharp increase in the Treasury Bill issue". The August 1, 1968 adjustment was made to lessen the danger of sudden shying away of substantial funds from Treasury Bills. Since the inception of the Bank in 1959, there have been numerous changes to the Treasury Bills structure to maintain the competitiveness of the Bills with other short-term forms of investments. These changes are shown in the table below :

Table 3-2 Treasury Bills Rates: 1959 - 1969 (% p.a.)

| Treasury Bills Discount Rates | 3 months | 6 months | 9 months | 12 months |
|---|---|---|---|---|
| Effective 29. 7.59 | 3 | 3 | $3\frac{1}{2}$ | $3\frac{1}{4}$ |
| Effective 1. 7.60 | 4 | 4 | 4 | 4 |
| Effective 10. 8.61 | 5 | 5 | 5 | 5 |
| Effective 15. 2.62 | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ |
| Effective 30. 8.62 | 4 | 4 | 4 | 4 |
| Effective 25.11.64 | 5 | 5 | 5 | 5 |
| Effective 2.12.64 | 5 | 5 | 5 | 5 |
| Effective 15. 3.65 | 5 | 5 | 5 | 5 |
| Effective 26.11.65 | 5 | 5 | 5 | 5 |
| Effective 1.10.66 | 5 | 5 | 5 | 5 |
| Effective 20.11.67 | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ |
| Effective June, 1968 | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $5\frac{1}{2}$ |
| Effective August, 1968 | 4 | $4\frac{1}{2}$ | 5 | $5\frac{1}{2}$ |

Source: Bank Negara Malaysia, Annual Report and Statements of Accounts, 1950 - 68.

Coming back to our illustration of Treasury Bills, on the due date the buyer of a Bill is entitled to the full face value. In the case of a $10,000 Bill, the face value will be $10,000, thus giving a profit or interest of $550. Treasury Bills are issued on tap, that is, a purchaser can buy any amount any time he likes. However, there is an upper limit imposed by Parliament. This, at the moment, stands at $1,000 million and it would therefore follow that the Bank can issue on behalf of the Government, Treasury Bills up to $1,000 million. This amount, however, can be varied by a resolution in the Dewan Rakyat. The total issue to-date is about $650 million, of which more than 60 per cent have been issued for 3 months.

The Bank itself buys Treasury Bills as part of its investment programme and at the moment holds some $30 million worth. In addition, in order to develop a short term money market in Bills, it is prepared to purchase Treasury Bills from any one who holds them, the purchase price being determined by different rates of rediscount, depending on the number of days the Bank is required to hold the Bill before maturity. Further, it is prepared to sell from its own holding, Bills of less than 3 months' duration.

(vi) Short-Term Money Market

The development of the short-term money market was facilitated by the commencement of business of Short Deposits (Malaysia) Limited towards the end of 1963. The purpose of this company, the first discount house in Malaysia, is to try to find more profitable employment of surplus short-term funds. As the name implies, Short Deposits (Malaysia) Limited accepts short-term deposits from commercial banks, firms and other organisation, the deposits being on call or on short loan basis. With these deposits, it will buy Treasury Bills maturing within a few days' time or purchase short-term government securities maturing within three years. The majority of deposits placed with this discount house are repayable on the next working day, and this is particularly true of commercial banks.

The daily borrowings of this discount house from its customers are secured by Treasury Bills or Government securities which it keeps with Bank Neagra Malaysia. However, to onviate continual endorsement of Treasury Bills and the use of large stock of transfer forms, the Bank issues what is known as the State Custody Receipt to clients of Short Deposits at the latter's request. Short Deposits hands these receipts to their clients who hold them as securities in lieu of holdings of Treasury Bills or Government stock. On the repayment of the loan by Short Deposits the next day, these receipts are surrendered by the banks back to Short Deposits (Malaysia) Limited.

Should the discount house be unable to obtain fresh funds at any day to repay their call loans, they may either sell Treasury Bills on the market or rediscount them with Bank Negara Malaysia or, as a last resort, ask the Bank to advance the company sufficient funds to cover their outstanding position. However, repayments are normally made by accepting fresh funds from depositors. Advances made by the Bank are secured against Treasury Bills and carry a penalty rate of interest (currently 4¾%) which discourages the discount house from borrowing from the Bank, unless necessary. The above description is not unlike the working of discount houses in the London Market in the exercise of 'Lender of Last Resort' function of the Bank of England, except that it is redumentary here.

(vii) Investments

The funds of Bank Negara Malaysia available for investment are invested both locally and overseas. The principal sources of these funds are from the capital of the Bank, retained profits, deposits by banks, Government and others and funds obtained by the redemption of Board currency.

There has been a general increase in the funds vailable since June 12, 1967, when the Bank became the sole currency issuing authority in the country. Currency Board notes are collected by the Bank and surrendered to the Currency Board in exchange for sterling at the rate of 2sh. 4d. to the dollar. In 1968, this is the major source of increase in the funds available for investment. To illutrate the general increase of the sources of funds for investment, let us take the growth of only one component of the sources, namely retained profits, since 1959. This is illustrated in Table 3-3.

Table 3-3 The Growth of Retained Earnings or Profits of Bank Negara Malaysia : 1959 - 1968.

| Year | Retained Profits | General Reserve Fund |
|---|---|---|
| | (in hundreds of thousand) | |
| 1959 | $ 1,834.8 | $ 1,834.8 |
| 1960 | 3,046.4 | 4,881.3 |
| 1961 | 2,715.8 | 7,597.0 |
| 1962 | 2,591.8 | 10,188.9 |
| 1963 | 2,186.0 | 12,374.9 |
| 1964 | 2,835.8 | 15,210.6 |
| 1965 | 6,993.7 | 22,204.4 |
| 1966 | 7,126.9 | 29,331.2 |
| 1967 | 10,602.8 | 20,934.0 |
| 1968 | 27,005.4* | 31,939.4 |

* Only $11,005.4 was transferred to the General Reserve Fund, the balance ($16 million) being transferred to the Federal Government.

Source: Bank Negara Malaysia, Annual Report and Statement of Accounts, 1959-1968.

As we can see, the increase in the retained profits of the Bank has been a steady one. These provide one of the sources with which the Bank invests over the years for the continued success of the Bank.

The Bank makes substantial overseas investment. It is the requirement of the law that at least 35 per cent of the deposit liabilities and a minimum of 80.59 per cent [9] of the total currency in circulation is backed up by overseas reserves or assets. The Bank has been able to maintain its external assets well above these minimum requirements. Income from overseas investments makes a sizeable proportion of the total income of the Bank.

Where and how are the funds invested? In the United Kingdom, the funds are invested in U.K. Government Securities, U.K. Government Treasury Bills and money at call. The U.K. Government Treasury Bills give a yield of approximately 6.58 per cent, and while giving a fairly adequate rate of return are also a very liquid form of assets. These Bills can be rediscounted at any time especially when there is a need for funds. The U.K. Government securities are longer term stocks maturing within 5 years and give a higher return in terms of income.

9 Gazette Notification No.P.U. 270 dated June 12, 1967. See also Section 29(a) and (b) of the Central Bank of Malaysia Ordinance, 1958.

In the United States, most of the money is placed as deposits for a fixed period of time. In addition, investments have also been made in the United States Government Treasury Bills and in fixed interest-bearing bonds issued by the International Bank for Reconstruction and Development (World Bank).

The Bank also has, as part of its investments, gold which is kept in the Bank of England and the Federal Reserve Bank of New York. In addition, the Bank has investments in Europe, mainly in Switzerland, Germany, France and the Netherlands, in the form of time deposits.

(viii) Government Investments

The Bank, through the Accounting and Investments Department, acts as adviser to the Government as regards overseas investments.

The determination of policy is the prerogative of the Treasury. However, good relationship have been built up between the Bank and the Treasury over the years and it has become normal practice for the Bank to be consulted. Before making its recommendations, the Bank would consider such matters as (a) the amount of money available for investment and (b) where such funds should be invested, bearing in mind :-

(i) the need for a secure investment;
(ii) relative yields obtainable;
(iii) the availability of suitable investments;
(iv) the exchange risks involved.

The department liaises with the Accountant-General's Office in making arrangements for placement of Government funds overseas. The Treasury is supplied periodically with information as to the state of affairs of the Government's investments.

(ix) Malaysian Government Securities

The Bank also deals in Malsyaian Government securities. Though not generally know, the Bank is usually prepared to buy from and sell to anyone Malaysian Government securities. At the end of every month, the selling and buying prices of the various securities are worked out by the department and circulated to the Stock Exchange, brokers and to various Branches of the Bank. The prices quoted are those at which the transactions take place though occasionally adjustments are made either to exclude or include interest accrued since the last published list of prices.

(x) Statistics

This section of the department is concerned mainly with the maintaining of statistical records. Daily statements of external assets and the summarised operations statistics (compiled from information supplied by Branches) are prepared for submission to the Governor, Deputy Governor and Adviser, who are thus kept informed of the positions.

In addition, statistics of cash movements, yields of different stocks, interest rates, offered by various verseas banks, yield curves, etc. are also maintained, mainly for investment decision purposes.

Further, the section also supplies the Treasury, Accountant-General, Chief Statistician and other interested departments, with different statistics required by each. Relevant figures for the Annual Report of the Bank originating from this department are compiled by this section.

(xi) Public Debt

While policy matters are decided by the Minister of Finance, the day-to-day management of this section is under the supervision of the Manager, Accounting and Investments Department. The Public Debt Section is headed by an Accountant who is answerable directly to the Registrar of Public Debt, who happens to be the Manager, Accounting and Investments Department. For convenience, routine matters relating to the Public Debt Registry have been entrusted to the Kuala Lumpur Branch Manager, since the Section is housed in the same building as the Kuala Lumpur Branch. The Registrar of Public Debt's office is in the Head Office Building.

The Public Debt Section keeps the registers of all loans issues, effects transfers, transmissions, and makes interest payments, etc. Registers of holders are normally closed for a period of two weeks before the interest payments date, so as to give the section time to check the registers and prepare interest warrants.

In the past, the Government has cloated three loans a year. Individuals are encouraged to subscribe to these loans. The minimum subscription is for $100 stock. If a loan is not officially opened for public subscription, the public can still subscribe or invest their money as 'advance deposit'. The advance deposits received will be applied to the next loan open. Thus, anyone can buy Government stocks at any time during the year.

(xii) Stock Exchange

The Bank has also taken a keen interest in the progress of the Stock Exchange, as this is necessary for an orderly development of the money market, which the Bank is trying to develop in Malaysia. A close link is maintained with the Stock Exchange by the Bank through the Accounting Department. However, the Bank does not interfere with the working of the Stock Exchange, but its advice is sought from time to time.

In the past, companies who wished to issue shares to the public used to send their prospectuses to the Bank for scrutiny and comments. However, in June 1968, the Capital Issues Committee was set up to formalise these arrangements. All public share issues, including private placements, have to be submitted to the Committee before the issues take place. The Chairman of this Committee is the Governor and the members are from the Ministry of Finance, Ministry of Commerce and Industry, and a member of the public. The main functions of this Committee are (i) to ensure that companies inviting the public to subscribe for shares give adequate information to the public and (ii) to regulate the timing of issues. Correct information is essential to prevent non-bona fide companies to float capital to take advantage of the current "share-mania" of the public. This is reflected in the over-subscription of many share issues recently. The proper timing of an issue will ensure a systematic approach to the capital market and avoid clashes with the Government's loan raising programme. The Secretary of the Committee is the Manager of the department who with his staff carry out the basic examination of the prospectuses of these companies. Agreement by the Committee to a public issue should not be taken as a seal of approval.

(xiii) Bank Negara Malaysia Staff Provident Scheme

All the records of this scheme are kept in the department. A complete record of all contributions by each member and the Bank are maintained in the department and full particulars are available to all staff.

Periodic investment reviews are undertaken by the Secretary/ Treasurer, normally at least once in a month, and suitable investments are made.

(xiv) Miscellaneous Functions

(a) Malayan Muslim Pilgrims Corporation

The Governor is a member of the investment panel of this Corporation. Periodically the department assists in the investment review of the Corporation and suggests how the available funds should be utilised. The department also advises on other matters concerning the Corporation when called upon to do so (e.g. purchase of equipment, accounting procedure, etc.).

(b) Accounts

The preparation of the Fortnightly Statement of Assets and Liabilities, interim and annual accounts of the Bank are done by this department in addition to quarterly forecasts.

(c) Sales of Singapore Dollars

Bank Negara Malaysia is prepared to sell or buy Singapore dollars to or from any commercial bank. The commission charged is 1/16 per cent on the value of funds remitted. The arrangement is that the Accountant-General, Singapore would supply Bank Negara Malaysia with the necessary Singapore dollars while the Bank would supply Malaysian dollars to the Singapore Accountant-General. Settlement is made at weekly intervals. The necessary accounting entries for these transactions are done by this department.

After discussing the structure and functions of the Accounting and Investments Department, it is necessary now to find out the structure and working of a Branch of Bank Negara Malaysia. All the Branches have essentially the same structure and functions, since they are established according to the same model as that of the Kuala Lumpur Branch, the biggest and most important Branch of Bank Negara Malaysia. So no attempt is made to describe them all. For our purpose, the Kuala Lumpur Branch will act as a model of the Branches, and, in the process, try to find out any differences betwen the Branches structure-wise or function-wise.

Kuala Lumpur Branch as a Model of a Bank Negara Malaysia Branch

The Kuala Lumpur Branch started to operate not as a Branch but as a department within the Bank, known as the Banking Operations Department, with a Superintendent as its head. It was coverted into a Branch and redesignated as the Kuala Lumpur Branch sometime in 1965.

According to Section 4(b) of the Central Bank of Malaysia Ordinance, 1958, one of the onjectives of the Central Bank is "to act as a banker and a financial adviser to the Government". From this provision and Part V, Section 30 and Part VI, Section 32 of the same Ordinance, the Bank obtains its authority to act as a Banker to the Government and carry on its functions. The Bank is also bankers to Public Authority bodies and commercial banks; the latter because they are required to maintain accounts with Bank Negara Malaysia for maintaining statutory reserve deposits and for settlement of clearings. In other words, commercial banks are required to open two accounts in Bank Negara Malaysia, namely Reserve Account and Clearing Account.

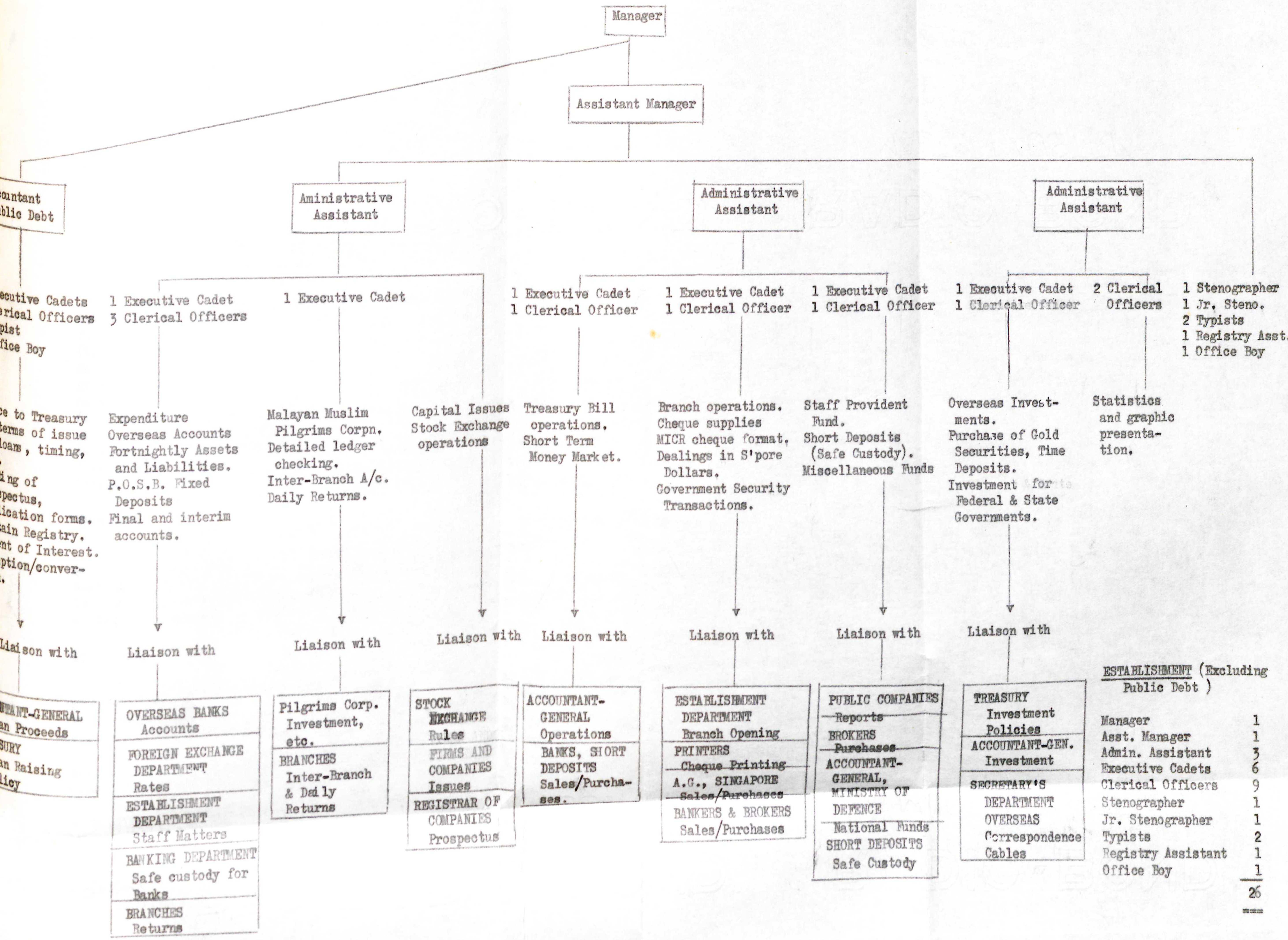
It is interesting to note that there is one difference, with regards to the accounts to be opened, between a commercial bank and the Central Bank. The difference is that most of the customers of a commercial bank are members of the public, while that of a Central Bank are mostly Government and semi-Government Departments and commercial banks and as such are impersonal. Dealings with the public are mostly in encashing cheques drawn on the Central Bank by government departments and occasionally in lodging into a government account for a purpose such as a deposit to enable the persons paying-in to tender for a job for a particular government department.

The types of accounts that the Branch can operate are restricted by the Central Banking Ordinance. Before an account can be opened it would have to be authorised by recognised representatives of the Government, Authority bodies and banks.

APPENDIX "C"

ORGANISATIONAL AND FUNCTIONAL CHART

ACCOUNTING & INVESTMENTS DEPARTMENT.




ESTABLISHMENT (Excluding Public Debt )

| | |
|---|---|
| Manager | 1 |
| Asst. Manager | 1 |
| Admin. Assistant | 3 |
| Executive Cadets | 6 |
| Clerical Officers | 9 |
| Stenographer | 1 |
| Jr. Stenographer | 1 |
| Typists | 2 |
| Registry Assistant | 1 |
| Office Boy | 1 |
| | 26 |

Structure of Kuala Lumpur Branch

The Head of the Kuala Lumpur Branch is the Manager, whose job is to administer the day-to-day running of the Branch. He is assisted by an Accountant. The other established post are quite different from the posts in the Head Office Departments, in the sense that most of the Branch appointments are classified ones. The classified posts, which demand more experience banking operations than paper qualifications, are the Chief Examiner, Examiner, Authorising Officer, Chief Cashier, Assistant Cashiers, Assistant Examiners, etc. They performed specialised functions in the Branch. For example, the Authorising Officer's job is to authorise the payments of cheques presented for encashment over the counter, while the Chief Examiner's main duty is to ensure the proper working of the Clearing House system.

In the other branches, the established posts are basically the same, there is a Manager and an Accountant in each branch. However, there is one difference in that in the other branches there is a post known as the Examiner#Authorising Officer, whereas in the Kuala Lumpur Branch these posts are separated.

The Kuala Lumpur Branch is divided administratively and operationally into eight sections, each specialising in its own functions. The sections are (i) Cash Section, (ii) Clearing Section, (iii) Overseas Section, (iv) General Section, (v) Machinists' Section, and (vi) Security Guards' Section. All the branches have generally this set-up, except that they have three more sections, namely, (i) Public Debt Section, (ii) Exchange Control Section and (iii) Currency Operations Section. The Kuala Lumpur Branch are without these additional sections because all the functions are taken up by the Public Debt Department, Foreign Exchange and Exchange Control Department and Currency Operations Department of the Head Office.

Functions

In the main, the functions of the Kuala Lumpur Branch are quite similar to those of commercial banks, like handling of customers' accounts, deposit-taking and foreign exchange dealings, to name only a few of the functions. The description of the functions of the Branch ensues. Only the main ones are described.

Cash Section

Besides doing the function of receiving deposits (cash, cheques, bills of exchange, etc.) from customers and payments of cash to customers, the Kuala Lumpur Branch, through its Cash Section, also provides the service of cash requirements of commercial banks. In other words, the Cash Section has the responsibility of providing physical cash requirements by commercial banks in Malaysia and of accepting surplus cash from them, thus enabling the banks to operate with the minimum of cash holdings in relation to their deposit liabilities in the country. If the banks experience the shortage of cash due to heavy withdrawals from their customers they can always resort to the Central Bank for the cash, by just writing a cheque drawn on their accounts. If, on the other hand, they have surplus cash they can just deposit it with the Central Bank and their accounts are accordingly credited. The nature of such operations handled by the Bank from 1959 is shown below:

Table 3- Servicing of Commercial Banks Physical Cash Requirements by Bank Negara Malaysia

( $ million )

| End of period | Supply of Cash to Commercial Banks | Acceptance of Cash from Commercial Banks | Monthly Average of Cash Holdings |
|---|---|---|---|
| | | | % |
| 1959 | 62.9 | 19.0 | 6.6 |
| 1960 | 195.3 | 177.0 | 5.4 |
| 1961 | 256.0 | 324.4 | 5.4 |
| 1962 | 332.5 | 349.1 | 5.3 |
| 1963 | 305.2 | 337.5 | 4.9 |
| 1964 | 460.0 | 497.0 | 4.2 |
| 1965 | 580.0 | 665.0 | 3.5 |
| 1966 | 658.0 | 716.0 | 3.6 |
| 1967 | 880.1 | 905.6 | 4.5 |
| 1968 | 770.3 | 754.8 | 3.1 |

Source: Bank Negara Malaysia Annual Reports.

## Overseas Section

Like any commercial banks, it deals with the issue of drafts, traveller's cheques to Government as well as to staff travelling overseas. It also handles transactions between the Bank and other Central Banks and correspondents which maintain accounts with the Bank (Nostro Accounts) and with whom the Bank maintain accounts (Vostro Accounts).

## Clearing House

The first Clearing House established in Malaysia started operations on January 29, 1959. A Clearing House is an institution where mutual indebtedness between banks in the banking system can be settled. The operation of the Clearing House in Malaysia is undertaken by the Central Bank. The service is now found in Kuala Lumpur, Penang, Johore Bahru, Kota Kinabalu and Kuching, that is, wherever there is a Bank Negara branch. Hitherto, when there was no clearing house, banks settled their inter-bank indebtedness by keeping accounts with each other. Now with the s setting up of Clearing House facilities by the Bank Negara, all banks have to open clearing accounts with the Bank and thus facilitating settlements.

## Foreign Exchange and Exchange Control Department

### Introduction

Exchange control was introduced in Malaysia, when Malaysia existed as separate entities of Malaya, Sarawak and Sabah, on 3rd September, 1939, at the outbreak of the Second World War, to conserve the gold and foreign exchange reserves.

For exchange control purposes, the world is divided into two parts :- the Scheduled Territories (known commonly as the Sterling Area) and the rest (usually referred to as countries outside the Scheduled Territories). Appendix 'D' shows the list of countries regarded to belong to the Scheduled Territories.

Exchange Control in Malaysia is only concerned with transactions with countries outside the Scheduled Territories. There are no restrictions on transactions with countries within the Scheduled Territories.

If we examine the history of Exchange Control in Malaysia since the establishment of Bank Negara Malaysia a decade ago, we will find that there was very little change in exchange control policy, except, of course, minor policy changes due to political reasons. Broadly the policy followed the currency arrangement and sterling payments system of the United Kingdom. There were no restrictions on current accounts transactions and capital receipts and payments in the Sterling Area. With regards to countries outside the Sterling Area, only capital accounts transactions were controlled. In respect of export of currency notes by travellers, a limit of $500 (Malayan dollars) plus £250 (Sterling) or the equivalent in other countries' currencies was imposed. This imposition persisted until October 1, 1968 when the equivalent of this £250 was lowered to M$1,000 per person. The minor changes in policy due to political reasons could be found in two instances. Firstly, in October, 1963 banks in Malaysia were required to designate the accounts of Indonesian residents as 'Indonesian Account' to prevent movements of funds that could be detrimental to Malaysia's interest in the light of the Indonesian Confrontation. However, on September 13, 1966 these restrictions were removed when Malaysian-Indonesian relations normalised. Secondly, in November, 1965 following Rhodesia's unilateral declaration of independence (UDI), this country was excluded from the Sterling Area and financial transactions involving residents of Rhodesia were restricted.

The current policy of exchange control in Malaya remains unchanged with respect to current and capital transactions between Malaysia and countries in the Sterling Area. Current payments to countries outside the Sterling Area continue to be unrestricted.

There is no restriction to payments of all kinds of imports. However, special regulations apply to Rhodesia regarding settlements of obligations to that country by residents here. As for discriminatory currency arrangements or multiple currency practices, these are not the policy of current exchange control in Malaysia and never had been so here.

Exchange Control Ordinance, 1953

The Exchange Control Ordinance, 1953 came into force on Jaanuary, 1st, 1954 to replace the former Finance Regulations. This is the statute under which Bank Negara Malaysia administers exchange control on behalf of the Federal Government.

The Ordinance gives the Controller of Foreign Exchange wide powers over transactions which, directly or indirectly, involve foreign exchange. It contains prohibitions and restrictions of a general nature and lays down with much detail what must be done and what may not be done. Practically every substantive sub-section begins with the words "Except with the permission of the Controller".

The Ordinance also confers on the Controller absolute powers to relax such prohibitions and restrictions by giving exemptions and permissions so as to make the Ordinance as flexible as is necessary to meet changing conditions.

# THE SCHEDULED TERRITORIES

Australia, including -
    Christmas Island
    Cocos (Keeling) Islands
    Nauru
    New Guinea
    Norfolk Island
    Papua

Bahamas
Baroados
Bermuda
Botswana
British Honduras
British Solomon Islands
British Virgin Islands
Brunei

Cayman Islands
Central and Southern Line Islands
Ceylon
Cyprus

Falkland Islands and Dependencies
Fiji

Gambia, The
Ghana
Gibraltar
Gilbert and Ellice Islands Colony, including -
    Gilber and Ellice Islands
    Northern Line Islands
    Phoenix Islands
    Ocean Island

Guyana

Hong Kong

Iceland
India, including -
    Andaman Islands
    Goa, Deman and Diu
    Nicobar Islands
    Sikkim Protectorate
    the former French establishments in India -
        Karikal
        Mahe
        Pondicherry
        Yanaon

Ireland, Republic of



,,,, 2

Jamaica
Jordan, the Hashemite Kingdom of

Kenya
Kuwait

Leward Islands, comprising :
Antigua (with Barbuda)
Montserrat
St. Christopher, Nevis and Anguilla (including Sombrero)
Lesotho
Libya, The United Kingdom of

Malawi
Malaysia
Maldive Islands, The
Malta
Mauritius

New Hebrides, Anglo-French Condominium of
New Zealand, including -
Cook Island, The
Ross Dependency
Tokelau or Union Islands
Nigeria

Pakistan
Persian Gulf Territories, including -
Bahrain
Muscat and Oman
Qatar
Trucial Coast Territories, comprising:
Abu Dhabi
Ajman
Dubai
Fujairah
Ras al Khaimah
Sharjah
Umm al Qaiwain
Pitcairn Islands

St. Helena and Dependencies, including Tristan da Cunha
Seychelles
Sierra Leone
Singapore
South Africa, Republic of, and the Territory of South West Africa
Southern Yemen, the People's Republic of
Swaziland

Tanzania, The United Republic of
Tonga
Trinidad and Tobago
Turks and Caicos Islands



..... 3

Western Samoa
Windward Islands comprising -
- Dominica
- Grenada and the Grenadines
- St. Lucia
- St. Vincent

Zambia

Exemptions and permissions are given by (i) Orders issued as Legal Notifications, (ii) Notices to Banks, (iii) approval of Forms such as Form E, F.1, T and E.2 and (iv) approval of an application in a specific case.

The principal effects of the provisions of the Ordinance and statutory orders made thereunder may be summarised as follows:-

What Must be Done

(i) Every person in Malaysia must offer for sale to Authorised Dealers their holdings of gold and specified currencies;

(ii) Bearer securities and securities registered in a register outside the Scheduled Territories must be deposited with Authorised Depositaries;

(iii) Proceeds of exports to countries outside the Scheduled Territories must be received in a specified currency or in a Scheduled Territory Currency from an External Account.

What May Not Be Done

(i) Buying or selling foreign currency or gold from or to a person who is not an Authorised Dealer;

(ii) Making payments in and outside Malaysia to persons resident outside the Scheduled Territories;

(iii) Making payment to a person resident in the Scheduled Territories as consideration for value received or to be received outside the Scheduled Territories by any person;

(iv) Issuing or transferring securities involving persons resident outside the Scheduled Territories;

(v) Issuing bearer securities;

(vi) Importing currency notes, Treasury Bills, gold, securities and the like;

(vii) Exporting currency notes, Treasury Bills, gold, securities, and the like;

(viii) Giving loans or overdrafts to companies controlled by persons resident outside the Scheduled Territories;

(ix) Doing any act whereby a company controlled by persons resident in the Scheduled Territories ceases to be so controlled;

(x) Taking any action to delay or avoid receiving payments of debts due from persons resident outside the Scheduled Territories.

## Administration

Exchange control was administered by a Section of the Treasury until Bank Negara Malaysia took over the administration on 1st August, 1960.

The Governor of the Bank is the Controller of Foreign Exchange and exchange control policy is determined by the Controller of Foreign Exchange in consultation with the Minister of Finance.

To facilitate the administration of the Ordinance, Authorised Dealers in Gold, Authorised Dealers in Foreign Currencies, and Authorised Depositaries, have been appointed. Certain authorities have been delegated to them. Authorised Dealers in Gold comprise leading commercial banks and bullion firms. Dealings in gold are restricted to such Dealers. Practically all banks in the country are also Authorised Dealers in Foreign Currencies, who have authority to deal in foreign currencies. Most banks are also Authorised Depositaries. Certain types of securities such as bearer shares and shares registered in a register outside the Scheduled Territories, have to be deposited with such Authorised Depositary.

Co-ordinatin with the Exchange Control are company registrars and the Royal Customs and Excise Department. Registrars are under instructions not to issue or transfer shares involving residents of non-Scheduled Territories countries unless exchange control requirements are complied with. The control over foreign exchange receipts and payments and transactions in securities is reinforced by control over import and export of goods in general and in particular gold, securities, currency notes and documents having a foreign exchange value. This control is exercised at the ports and other points of entry and exit as persons and things move in and out of the country and is administered naturally by the Royal Customs and Excise Department.

## Scope of Exchange Control

### Dealings in Gold and Foreign Currencies

These dealings are restricted to Authorised Dealers. Gold and 'specified' currencies held by residents have to be offered for sale to Authorised Dealers. 'Specified' currencies are defined as those currencies of countries outside the Scheduled Territories which have been specified by the Control; they include most of the principal currencies of the world, such as Austrian Schillings, Belgian francs, Canadian dollars, Danish kroner, Deutschemarks, French Francs, Italian lire, Japanese Yen, Dutch guilders, Norwegian kroner, Portuguese escudos, Spanish pesetas, Swedish kronor, Swiss francs and US dollars.

### Control of Payments to countries outside the Scheduled Territories

Payments to these countries are prohibited unless they are made with Exchange Control approval. Much of the authority for approving current transactions has been delegated to the Authorised Banks. The following are the main categories of payments :-

(a) Imports

Approval for payments for imports from countries outside the Scheduled Territories is given for goods imported or to be imported for which a specific licence has been obtained or which are permitted under Open General Licence, provided certain exchange control formalities are complied with, namely, the submission of evidence of shipment or importation of the goods.

(b) Contr.ctual liabilities of a commercial nature, such as freight, insurance, commissions

Approval is given when satisfactory documentary evidence that payment is due is submitted.

(c) Travel

Residents of Malaysia are entitled to a travel allowance of $5,000 in foreign exchange facilities per person per calender year for holiday travel outside the Scheduled Territories. Certain allocations for foreign exchange are also allowed for travel for business, official duties, and health, and for Mecca Pilgrimage

(d) Sundry Payments

Reasonable amounts are approved for education, maintenance and family remittances.

Receipts for Exports

Payments for exports from Malaysia to countries outside the Scheduled Territories should be received in a prescribed manner and within six months from the date of export. The prescribed manner of payments for exports is (a) payment in any specified currency, (b) payment in a Scheduled Territory currency from an External Account.

Import and Export of Currency Notes

(a) Import of Currency Notes. Travellers may bring into Malaysia: (i) Malaysian currency notes up to M$500 per person; (ii) Currency notes of other countries, except Indonesia and India, without limit (import of Indian Rupees is limited to Rs. 270 and Indonesian Rupiahs to Rupiahs 3,000); (iii) Travellers' cheques and letters of credit, without limit.

(b) Export of Currency Notes. Travellers may take out of Malaysia: (i) Malaysian currency notes up to M$500 per person; and (ii) Currency notes of other countries up to the equivalent of M$1,000 per person.

(c) Visitors. Visitors to Malaysia may, on leaving Malaysia, take out with them foreign currency and Scheduled Territory currency notes (other than Malaysian currency notes) up to the amount they brought in with them. To prevent inconvenience, visitors should be advised that on their arrival in Malaysia they should report to the Customs the amount of currency notes which they have with them and which they would like to take with them on their departure.

## Investments outside the Scheduled Territories

Investment by residents of Malaysia in countries outside the Scheduled Territories may be made only upon approval of the Control; this is given only when such investments are considered to serve the economic interest of the c ountry.

## Investments by Residents of Countries outside the Scheduled Territories

(a) Securities. The issue or transfer of securities to residents of countries outside the Scheduled Territories requires permission. When permission is given, it is normally on condition that payment is made in a specified currency or funds from an External Account. When securities are sold by residents of countries outside the Scheduled Territories the proceeds of the sale may be repatriated through official exchange.

(b) Direct Investment. Direct investments in Malaysia by residents of countries outside the Scheduled Territories require the prior approval of the Exchange Control. When approval is given it would normally be subject to the submissi on of a certificate by a bank in Malaysia that payment for the investment has been received in a specified currency or funds from an External Account. Profits may be remitted to residents of countries outside the Scheduled Territories when the Control is satisfied, after examination of the relevant audited statements of accounts, that the profits have been made and local liabilities have been provided for. The proceeds of the sale of investments in Malaysia by residents outside the Scheduled Territories, on the other hand, may be repatriated through official exchange, once exchange control approval has been obtained.

## Functions of the Foreign Exchange and Exchange Control Department

The functions of this department are the administration of the Exchange Control Ordinance and the prevention of evasion of its provisions.

Much of the authority for normal current transactions has been delegated to the Authorised Banks, including Branches of Bank Negara Malaysia. The banks need only refer to the Control such transactions as are not within their authority. Some of the items dealt with by the Exchange Control are: (i) determination of residential status, (ii) Emigration to countries outside the Scheduled Territories, (iii) Portfolio and direct investments in Malaysia by residents of countries outside the Scheduled Territories,

(iv) Portfolio and direct investments outside the Scheduled Teritories by residents of Malaysia, (v) remittance of dividends and profits and, (vi) Payment of a capital nature.

The Control keeps a supervisory control over the banks by requesting for monthly returns, for instance, of their operations in foreign currencies, and by examining the exchange control forms which have been approved by them.

Structure of the Department

The department is under the charge of the Superintendent of Foreign Exchange. He is assisted by the Assistant Superintendent two Administrative Assistants, three Executive Cadets and two Research Assistants. In addition, the s taff include also Clerical Officers, Stenographer, Junior Stenographer, typists and office boys just like any other departments of Bank Negara Malaysia.

The last department of Bank Negara Malaysia to be described and one of the most important is the Currency Operations Department. It is one of the 'Special Central Bank Department', established to fulfil one of the objects of the Central Bank and established to enforce one of the provisions of the Central Bank of Malaysia Ordinance. It is to the structure and functions of the Currency Operations Department that we turn our attention now.

## Currency Operations Department

### Introduction

One of the principal objects of Bank Negara Malaysia is to issue currency in Malaysia and keep reserves safeguarding the value of that currency.

The Bank commenced issuing the new Malaysian notes and coin to replace the currency issued by the Board of Commissioners of Currency, Malaya and British Borneo (to give it its full name) on June 12, 1967. It is interesting to note why it has taken the Bank a bit more than eight years since its inception in 1959 before this most important function was finally realised. In fact, Bank Negara Malsyia has had currency issuing powers from the outset but they were held in abeyance so that member countries of the Currency Board could investigate the possibilities of some form of common currency arrangement when the Board ceased to issue currency. After the establishment of Malaysia in September, 1963 which brought into a political federation all the Participating Countries except Brunei, the Malaysian Government lodged with the Currency Board on December 12, 1964, notice of its intention to replace the Board by Bank Negara Malaysia as the sole currency issuing authority in Malaysia. Under the provisions of the Currency Agreement, 1960, the lodgement of such a notice involved the relinquishment by the Currency Board of its powers to issue notes not later than December, 1966 and coin a year later.

Preparatory work on the issue of Malaysian currency was started some years ago; in fact, designs for the notes and coin were first considered as early as 1961 but, apart from this, no detailed planning was undertaken until the question of the establishment of Malaysia was decided. By mid-1965, preparations by the Bank to assume currency issuing powers had reached an advanced stage but these arrangements had to be reviewed when Singapore became independent in August, 1965. Negotiations with the Singapore Government for a common currency to be issued by Bank Negara Malaysia to circulate in both Malaysia and Singapore did not result in finding a satisfactory formula acceptable to both parties and it was decided to issue separate currencies. By agreement, the Currency Board's right to continue issuing currency was subsequently extended for a further six months, that is, until June 12, 1967. Once this date has been established, the Bank began to finalise arrangements for the issue.

Thought was first given to constructing adequate storage facilities in Malaysia in early 1965 immediately subsequent to the lodgement of notice in December, 1964 by the Government to the Currency Board that the Bank would assume currency issuing powers. After Singapore's separation, storage became a major practical problem as the great bulk of security accommodation was located in Singapore. The project was therefore given top priority and the Batu Tiga Currency Office, with over 6,000 square feet of vault space, was completed in March 1967, only eight months after construction began.

## Legal Provisions

Part III of the Central Bank of Malaysia Ordinance, 1958, empowering Bank Negara Malaysia to assume currency issuing powers was brought into force with effect from June 12, 1967, by a Government Gazette Notifications No. P.U.241 published on May 19, 1967. Since June 12, 1967, therefore, the Bank has been issuing the new Malaysian currency into circulation and withdrawing currency issued by the Currency Board. The old Malayan currency so withdrawn from circulation is presented to the Currency Board for redemption at the rate of 2sh. 4d. sterling for every Malayan dollar.

Under the provisions of Section 29 of the Central Bank of Malaysia Ordinance, the aggregate value of the reserve of external assets which the Bank is required to maintain shall not be less than such percentage of the Central Bank's notes and coins in circulation as the Minister of Finance may declare to correspond to the minimum reserve of external assets which the Currency Board would have been required to maintain against notes and coins issued by the Board under the Currency Act, 1960. Since the fiduciary element of not more than $300 million was permitted under the Currency Act, the minimum reserve of external assets which the Currency Board was required to maintain on June 10, 1967 (the last business day immediately preceding the assumption of currency issuing functions of the Bank), passed on the currency in circulation shown in the books of accounts of the Board, was 80.59%. Accordingly, the Minister of Finance has declared by Gazette Notification No. P.U.270 published on June 12, 1967, that the minimum of external assets which the Bank is required to maintain against its currency liabilities shall be 80.59%.

The parity of the new Malaysian dollar is provided in the Ordinance also. Section 19 states "The parity of the Malaysian dollar shall be equivalent to 0.290299 grammes of fine gold".

## Currency Interchangeability Arrangement

For the convenience of the members of the public, arrangements were made by an exchange of letters between the monetary authorities in Malaysia, Singapore and Brunei for the three new currencies to be interchangeable at par. The effect of this interchangeability arrangements is that Malaysian notes and coins are accepted at face value in Singapore and Brunei, and Singapore and Brunei notes and coins are accepted at face value in Malaysia.

## Structure of the Currency Operations Department

The Currency Operations Department which is headed by the Currency Officer is a comparatively new Department, bwing slightly over two years old. It is divided into two offices - the Head Office which is situated in the Headquarters Offices of Bank Negara Malaysia in Kuala Lumpur and the Batu TigaCurrency Office which is situated at the Sungei Rengam Industrial Complex about 16 miles from Kuala Lumpur enroute to Klang. The organisational structure of the department is shown in Appendix 'E' at the end of this Chapter.

## Functions of the Department

The principal functions of the department are outlined briefly below :-

### Head Office functions

(i) Procurement of currency supplies from the manufacturers. This function involves placing orders with the manufacturers for the Bank's requirements of notes and coins, taking delivery of the consignments and transporting them to the Batu Tiga Currency Office.

(ii) Servicing currency requirements of Branches. When currency stock of Branches run low, the Branches indent on Head Office for replenishments. Arrangements are made to send consignments by land (road and/or rail), sea or air as appropriate.

(iii) Supervision of Batu Tiga Currency Office. All policy matters connected with the procurement of supplies, issues of currency stocks, security arrangements, staff, expenditure and disbursements, etc., at the Batu Tiga Office are referred to Head Office for decision and approval.

(iv) Assessing awards of compensation for mutilated notes in doubtful cases. Doubtful cases of mutilated notes tendered for award of compensation by the public to Branches are submitted to Head Office for evaluation.

(v) Maintenance and compilation of Statistical records. The main books which are maintained in this department in regard to the currency issue are :-

(a) The Orders and Deliveries Registers for notes and coins. These books record the orders placed with and deliveries made by the manufacturers.

(b) The Master Stock Books which record the daily position of currency stocks at Branches and the Batu Tiga Currency Office.

(c) The Notes and Coin in Circulation Ledgers which show the daily gross circulation of Malaysian Currency and the fortnightly net circulation of Malaysian currency by denominations.

(d) The Notes Destruction Register which records the amount of notes destroyed per month.

The main statistical records which are compiled in this Department are :-

(a) Figures and graphs of receipt and redemption of Currency Board currency, that is, Board currency received by Nank Negara and surrendered to the Currency Board in exchange for sterling.

(b) Figures and graphs of Net Circulation of Malaysian Currency.

Batu Tiga Currency Office Functions

(i) Custody of main currency stocks. The main currency stocks of Malaysian notes and coin are held in the strong-room under the joint custody of the Assistant Currency Officer and the Chief Cashier.

(ii) Receiving Currency consignments from manufacturers. Regular shipments of Malaysian Currency from the United Kingdom to replenish stocks at this Office.

(iii) Distribution of currency stocks to Branches. On requisition by Branches, currency notes and coin are distributed to them.

(iv) Counting of Notes and Coin. Malaysian notes and coin received from the Kuala Lumpur Branch and repatriated by the Singapore Currency Board are counted by the Counting and Cancellation Section. In the process of counting, the Clerical Assistants also sort out soiled notes and detect forged notes.

(v) Cancellation of soiled notes. Soiled notes which are unfit for further circulation are canclled by means of electrically-operated cancelling machines.

(vi) Verification and destruction of cancelled and mutilated notes. These notes are verified by the Verification and Destruction Section prior to destruction by fire in an incinerator.

(vii) Maintenance of stock records. The main records which are kept at the Office are as follows :-

(a) The Aggregate Stock Books which record the daily stock position of currency at this Office.

(b) The Daily Movements Registers, as the name suggests, show the daily movements of currency stocks.

(c) Record of Cancelled (and mutilated) Notes Destroyed which shows details of cancelled and mutilated notes which have been verified and destroyed.

(viii) Implementation of security measures. Strict security measures are enforced at the Batu Tiga Currency Office. These measures are implemented by the Bank's Security Officer in conjunction with the Police and Assistsnt Currency Officer.

Liaison

For the efficient performance of the above functions, the Currency Operations Department maintains close liaison with organisations and departments as shown in a summarised manner in the "Organisational and Functional Chart": Currency Operations Department (Appendix 'E', at the end of this Chapter.

APPENDIX "E".

ORGANISATIONAL AND FUNCTIONAL CHART : CURRENCY OPERATIONS DEPARTMENT

LIAISON

CURRENCY OFFICER

HEAD OFFICE

LIAISON

BATU TIGA CURRENCY OFFICE

SECRETARY'S DEPARTMENT

BRANCHES

aily Currency Returns
ash Position
urrency Distribution.

OUNTING AND INVESTMENTS DEPARTMENT

edemption of Board Currency
urrency Statistics

CURRENCY BOARD

emption of Board Currency

RETARY'S DEPARTMENT

Cables
Board Papers

ABLISHMENT DEPARTMENT

Staff Matters
Printing, Stationery and Equipment

K SUPERVISION AND ERNAL AUDIT DEPT.

prise Check of Currency
tocks

IT DEPARTMENT

it of Currency Stocks

WN AGENTS

nting & Supply of Notes

AL MINT

ting & Supply of Coin

AL MALAYSIA POLICE

ice Escorts

NISTRY OF DEFENCE

pply of Road, Air and Sea Transport

ADMINISTRATION

ASSISTANT CURRENCY OPERATIONS OFFICER

1. Daily Currency Operations
2. Signing Duties
3. Checking of bills for payments
4. General Correspondence
5. General Supervision of Staff
6. Currency Escort and Distribution

EXECUTIVE CADET

1. Daily Currency Operations
2. Checking of bills for payment
3. Compilation of Currency Statistics
4. Award of Compensation of mutilated Notes
5. Checking of Postings, reconsiliations, etc.
6. Estimates.

CLERICAL OFFICERS

1. Posting of Control Ledgers
2. Reconciliation of Ledgers and Accounts
3. Clearance of Shipping and Customs Papers
4. Monthly Travel Insurance Declaration
5. Currency Escort Duties
6. Preparation of Statistical Graphs
7. Compilation of Statistics on:-
   (a) Board Currency Recipts and Redemption
   (b) Returns of Co-ordinating Banks
   (c) Currency Indent and Delivery
   (d) Shortages & Excesses in Counting Currency
   (e) Malaysia Currency Circulation.

JUNIOR STENOGRAPHER
TYPIST &
OFFICE BOY

STORAGE, DISTRIBUTION, VERIFICATION AND DISTRIBUTION OF CURRENCY

ASSISTANT CURRENCY OFFICER

1. Joint Custodian of Currency Stock
2. Staff Reports and Supervision
3. Supply of Stocks to Branches
4. Taking delivery of Currency Consignments
5. Correspondence
6. Security
7. Destruction of Notes

SECURITY SECTION

Batu Tiga Police

SECUTIRY OFFICER

1. In charge of Security guards
2. Implementation of Security measures.
3. Currency Escort Duties.

PENAL CONTROL OPERATOR

CHIEF SECURITY GUARDS

SECURITY GUARDS

VERIFICATION AND DESTRUCTION SECTION

VERIFICATION OFFICER

Supervision of Verification and Destruction Section

CASHIER

Assisting the Verification Officer

ASSISTANT CASHIER

Assisting the Verification Officer

CLERICAL ASSISTANTS

1. Verification of Notes
2. Detection of Forgeries.

Currency Hand

CHIEF CASHIER

1. Joint Custodian of Currency Stocks
2. Taking delivery of currency Consignments
3. Supply of Stocks to Branches
4. Daily Returns
5. Repatriation of Malaysian Currency from Singapore

COUNTING AND CANCELLATION SECTION

CASHIER

Supervision of Counting and Cancellation Sec.

ASSISTANT CASHIER

Assisting the Cashier

CLERICAL ASSISTANTS

1. Counting and Cancellation of notes.
2. Counting of Coin
3. Detection of Forgeries

DISTRIBUTION AND GENERAL OFFICER

CLERICAL OFFICER

1. Posting of Stock Books
2. Currency Escort Duties
3. Miscellaneous

TELEPHONE OPERATOR AND RECEPTIONIST

TYPIST

ARMOURED CAR DRIVER

FORK LIFT DRIVER

CURRENCY HAND

## CHAPTER IV : Some Aspects of Central Banking in Malaysia (1959 - 1969)

### Introduction

We have so far examined the Malaysian monetary system before the establishment of Bank Negara Malaysia in 1959, that is, the Malaysian monetary system without a central bank but with a Currency Board system to regulate currency supply. At the same time, we also traced the events leading to the formation of a central bank in this region thus signifying the era of monetary independence for Malaysia. Then in Chapters II and III, the growth of the internal organisational structure of Bank Negara Malaysia since 1959 till now was looked into. We also discussed, mainly in Chapter III, the structure and functions of each separate department and branch of the Bank, thus giving an insight into the real working of a modern central bank.

In this present Chapter, an attempt will be made to examine the nature and growth of Bank Negara Malaysia since its official opening in 1959, other than the growth in its organisational structure and other aspects which have been touched upon in previous chapters.

But before doing so, let us digress a little to talk about central banking in general to enable us to have a broad idea as to what a central bank really is. Central banking is a comparatively recent development and, like many other methods of state intervention and control, it is still in the process of development and expansion. Before the beginning of the twentieth century, there has been no clear-cut concept of central banking, although a gradual evolution has taken place in various countries over a long period of years. This evolutionary process, however, is not always a conscious one. In many of the older countries, especially those in Europe, one bank gradually came to assume more and more the position of a central bank due mainly to its monopoly rights of issue of bank notes and acting as the government's banker and agent. Their principal function was the maintenance of the convertibility of the notes into gold and silver.[1] Later, such banks of issue acquired other functions, duties and powers until the term 'central bank' came to be generally used.

What can be considered to be the modern meaning of a 'central bank'? Trying not to be sophisticated, perhaps Professor Sayers' definition is acceptable for our purpose.[2] He defines a central bank as "the organ of government that undertakes the major financial operations of the Government and by its conduct of these operations and by other means, influences the behaviour of financial institutions so as to support the economic policy of the Government".[3] It should be noted that the element of government is pronounced here, implying state intervention in monetary affairs of a country.

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1 Notes and coin were the chief means of payment in those days. In the present day money economy, bank money or demand deposits are the more important components of money supply.

2 Of course, there are other interpretations by many writers on the central banking concept.

3 R.S. Sayers: Modern Banking, Oxford University Press (Seventh Edition) Pg. 66 His definition applies to the British context.

A central bank differs from a commercial bank in at least four important respects :-

(a) the special relationship with the government;
(b) the absence of the profit motive;
(c) its influence over the commercial banks; and
(d) its non-relationship with the private sector.

The acceptance of central banking as a form of state intervention and control is a development of the last 50 years. In 1913, there was only one full-fledged central bank in existence - the Bank of England - although a number of European countries have banks of issue and the Federal Reserve System had just been established in the United States.

For a long period the Bank of England model had been a strong influence on the development of central banking elsewhere especially in the British Empire. This was inevitable because of the immense experience it had accumulated over the years and its towering authority enjoyed in England. However, there were some elements in the Bank of England model that were not directly applicable to would-be central banks. These were appreciated, nevertheless through trial and error. Present day thinking about the functions of central banks is the outcome of this process and experimentation of gradual adaptation of the original Bank of England concept, both to the different needs of many countries at widely different stages of economic development with different institutions and political systems and to the profound change that has occurred in the last 50 years in the role assigned to national governments in monetary and economic policy.

The functions of central banks can be classified broadly into two types :-

(a) the "traditional functions" which are concerned directly or indirectly with monetary policy, and

(b) the "developmental functions", which are concerned with the promotion of economic growth and of sound monetary and financial institutions.

The above distinction, however, is not clear-cut. There is a certain amount of overlapping, though. Monetary policy, like all economic policy, must strike a balance between stability and growth and one of the objects of central banks in encouraging the development of financial institutions is to facilitate the tasks of monetary policy.

The "traditional functions", since they are concerned somehow or other with monetary policy, include the familiar note-issue function, Banker's Bank Function, control of bank credit function and government banker and financial adviser functions.

The developmental functions" in the case of Malaysia are implied in one the statutory objects of the Central Bank - "to promote monetary stability and a sound financial structure in the country".[4] Therefore Bank Negara Malaysia is committed under the law to carry out the developmental functions in order to provide adequate financial institutions as well as to ensure the smooth and efficient running of the Malaysian monetary and barkig structure. Even in the highly developed economies, central banks have made it their business to further the sound growth of banking and other financial institutions. The Bank of England, for instance, has not only continuously kept an eye on the working of Britain's capital market but also at times directly sponsored and helped finance new financial institutions. Similarly, the Reserve Bank of Australia has frequently taken the initiative in sponsoring specialised financial institutions or by encouraging private action as in the case of the establishment in 1959 of an official money market organised by private discount houses.[5] In countries with large non-monetised subsistence sector, their inadequate banking systems and their rudimentary capital markets, the role of central banks in developmental efforts is all the more important. The promotion of a large and a more efficient banking and credit system and direct financial aids in economic development are priority tasks of new central banks. The Malaysian Central Bank, as we shall see later, is no exception. This is because a larger and an efficient banking and credit system is a part of the essential infrastructure without which economic development is hardly possible. The job of an efficient money market and a capital market is to facilitate the transfer of short and long-term funds between demanders of such funds and suppliers and also to encourage savings by giving wide access to convenient assets and to channel available investible funds at the lowest possible cost to the most productive use.

After Surveying briefly central banking in general, we now narrow our perspective to that of Malaysia. For analytical purposes, the survey on central banking in Malaysia (1959 - 1969) will be done in two stages :-

(1) "Traditional Functions" of Bank Negara Malaysia, and

(2) "Developmental functions" of Bank Negara Malaysia.

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4 Section 4(a) Central Bank of Malaysia Ordinance, 1958.

5 At present there are 9 such markets in Australia.

Traditional Functions

It should be accepted that monetary policy must be and should be a facet of the overall economic policy of the government and the country. In order to be effective, central banking policy must go hand in hand with fiscal policy; it must not have an independent and separate existence.[6]

Monetary policy has as its main function to make money as a means for the achievements of economic goals within the confines of public purpose. This statement implies that money is regarded as an economic catalyst rather than a neutral device that simply serves as a standard of value and a medium of exchange as postulated by the classical economists of old. In other words, modern money is a controlled promotive force rather than an adaptive servile mechanism. Also, the adoption of a central banking policy, together with fiscal policy and balance of payments policy, forming the overall economic policy of the country, presupposes certain desirable economic goals to be achieved by the economy. For a developing economy like Malaysia's, the desirable objectives are perhaps to maintain internal and external stability, to stimulate economic growth and to maintain a high level of employment. The attainment of these objectives depend, as we have noted, upon government policy, part of which is central banking policy, which operates through its incluence on the volume and availability of credit.

In its strictest sense, the purpose of monetary policy is to control the quantity of money supply and its distribution according to the needs of the economy. The money supply, in turn, consists of two components: demand deposits, 'manufactured' largely as it were by the commercial banking system, and currency (notes and coin), issued only by the central bank. Since a full-fledged central bank all over the world only has the powers to issue currency, central banking policy, in effect, is directed principally to the management of the processof credit creation of the commercial banks. However, in the case of Malaysia, its Central Bank has to wait eight years since its formation before it becomes a full-fledged central bank. For the first eight years, it has to operate side by side with the Currency Board system, which was given the monopoly rights of currency in this area since the beginning of this present century. This is a curious situation indeed in the monetary history of South-East Asia if not the whole of Asia. The Central Bank's lack of control over the currency supply and the automatic character of the Currency Board system have restricted the ability of the Bank to influence the money supply. Because of this, deliberate management of the money and credit situation to the national advantage was not wholly possible.

It is interesting to note one essential difference between monetary policy under the old Currency Board system and one under a full-fledged central bank. Under the former, monetary policy tends to be a passive one, due to the very nature of the system itself.

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6 Monetary policy includes central banking policy, budget or fiscal policy and balance of payments policy.

principal characteristics of the Currency Board system are the automatic rule of its working and its fusion with external trade factors. The amount of money in the country depends on the amount of foreign exchange that flows into the country. The higher the foreign exchange reserves the bigger will be the currency supply and vice versa. Hoe do we get foreign exchange in the first place? The answer is through international trade. If there is a favourable balance of payments foreign exchange will flow in, with the consequent increase in the money supply. Conversely, if there is an unfavourable balance of payments, foreign exchange flows out to finance the deficit resulting in the contraction in the money supply. So there is a certain amount of automatic mechanism operating on the monetary system. This is more directly applicable to a country like Malaysia, whose economy is one of the most open in the world. The passive role of monetary policy under the Currency Board system is also reflected in the inability of the Board to control the credit creation or contraction of the commercial banking system. Commercial banks were under the regulation of the Companies Ordinance, 1940, which did not actually attempt to regulate the activities of the commercial banks. All these will be remedied under the full working of the Central Bank of Malaysia. The role to be played in the monetary management will be an active one, with its control of both the components of the money supply.

In developed countries, control over the volume of credit has for long been the main monetary policy function of central banks because in these countries the bulk of money supply consists of bank deposits which commercial banks create in the process of lending. In classical central bank theory, central bank control over bank credit came to be synonymous with the two instruments of control which the Bank of England evolved after 1870, namely, the Bank Rate and the open market operations. Open market operations are brought about through the sale and purchase of government securities in the open market by the Bank of England, which enables the Bank to influence the liquidity of the banks and since the banks have come to work to a fairly strict and uniform cash ratio, their capacity to lend. The primary function of the Bank Rate, on the other hand, is to reconcile control over the bank liquidity with the Bank of England's functions as lender of last resort. In the peculiar British situation, where the banks borrow never directly from the Bank of England but use discount houses as intermediaries, this function is performed by the rate at which the Bank of England stands prepared to discount first class trade bills. The Bank Rate also comes to serve two other purposes:

(a) as a signal of changes in the interest rate structure of the economy, and

(b) As the means of regulating international short-term capital movements in the interest of short-term balance of payments policy.

In Malaysia, where the money and capital markets are in their rudimentary state, these tools of policy are not directly applicable. However, with the developmant of these markets which Bank Negara Malaysia is trying very hard to organise the open market operations and the Bank Rate policy instruments will be applicable if the necessary conditions already exist.

Since its inception in 1959, Bank Negara Malaysia are provided with various other monetay instruments to influence the money supply of the country. These are stipulated in the Central Bank of Malaysia Ordinance, 1958, and they include minimum liquidity ratio, statutory reserves, prescription of structure of interest rates of commercial banks, and qualitative advance policy.

## Legal Minimum Requirements

Most central banks now have this power though there is great variation in detail. In the most common form, the central bank may require the commercial banks to hold with itself minimum reserves of an amount equal to a uniform percentage of total deposits (at different percentages of current or fixed deposits), the percentage being freely variable at the discretion of the central bank. Legal minimum reserves in one form or another are undoubtedly one of the most effective methods of central bank control of bank liquidity and of the volume of credit. But they are not without difficulties. If they are used gently, leaving the banks with an excess of liquidity, the banks may ignore them under strong pressure of demand for bank credit. If, on the other hand, they are used forcefully so as to reduce the banks' liquidity to their own safe minimum, they are liable to antagonise the banks. For this reason, supplementary instruments to control commercial bank liquidity are used. One method is through open market operations and the use of facilities as lender of last resort, as well as for the central banks to try to rule by cooperation rather than through coercion, a method which has become known in central bank literature as 'moral suasion'.

In the case of Malaysia, the liquidity and the reserve ratios are designed both as a protection for depositors' funds in the commercial banks and also as a means of influencing the credit situation to the advantage of the country as a whole. How could the Central Bank use such monetary tools to meet these ends? In times of inflationary pressure on the economy, caused for instance by an export-induced boom, the Central Bank could impose these monetary policy instruments at a level which would be high enough to prevent the banks from extending further credits which might otherwise add such pressure in the economy. It is also the purpose of the liquidity ratio, in collaboration with the local assets ratio measure, to influence the types of assets which the Central Bank is prepared to accept from commercial banks towards fulfilling these two requirements, at the same time, the amount of investments by banks in the interest of the country. The imposition of the local assets ratio could result, for example, in more investments in Malaysia by the banks while observance of a liquidity ratio could lead to the holding by commercial banks of more Government Treasury bills and other types of Government securities.

Bank Negara Malaysia first introduced the legal minimum liquidity standard in November, 1959. Bank Negara suggested to Commercial banks to observe a liquidity ratio of 20% of total deposits liabilities, excluding other banks' deposits.[7] "This was more of a preventive than a corrective measure since most of the banks in the Federation have kept themselves fairly liquid".[8] However, the state of liquidity among the banks was not a uniform one. Some did not observe proper maintenance of liquidity, especially so before the Central Bank appeared on the monetary scene. It was for this reason that Bank Negara Malaysia introduced this measure, though it had to be non-discriminatory in its action on the commercial banks. It was for this reason also, that the 20% ration was suggested, since all banks could comply without difficulty and thus banish the element of discrimination. At the same time, commercial banks were also required to open two accounts in the Bank, one known as the reserve account which was legally required and the other one known as clearing account, which was voluntary. At first only the clearing account was required, but banks were asked to keep at least $2\frac{1}{2}\%$ of the total clearing balance in the account. This was done to pave the way for the introduction of the reserve account, which eventually was set at 4%, and was known later as the statatory reserve ratio.

The state of commercial bank liquidity after one year of the Bank's operation was satisfactory. The average liquidity of the banking system was 44.4% of total deposits liabilities in 1960 compared to 48.6% in 1959, signifying a fall of 4.2%. However, the proportion of advances to deposits rose from 48.6% in 1959 to 53.6% in 1960. This was a satisfactory state of affairs, although some banks operated quite close to the 20% liquidity ratio. Therefore, the ratio was not changed. The statutory reserves of 4% also ramained unchanged.

During 1961 there was a significant change in the minimum liquidity ratio which the commercial banking system must observe. What happened was the liquidity position of the banks caused much concern to the Central Bank. Even though the rate of deposits rose this was offset by an even greater increase in advances, resulting in lower liquidity situation. The increase in bank landing was due to financing of speculative share dealings. These activities might lead to some banks becoming over-extended and thus vulnerable to conditions involving sudden withdrawals of depositors' funds. In view of these developments, steps were taken by the Bank to remedy the unhealthy tendencies, in order to safeguard the safety of depositors' funds and the interest of the economy as a whole. One of these steps was that with effect from the first of January, 1962, banks in the country should observe a liquidity ratio of 25%. The new liquidity standard now included all government securities, subject to a maximum of 5%, in the computation of the ratio. There was no change in the ratio of the statutory reserves.

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7 This was merely a suggestion at first.

8 Bank Negara Malaysia : Annual Report and Statment of Accounts Pg. 5.

The minimum liquidity ratio and the minimum reserve ratio were reviewed in lat 1964 to take account of the formation of Malaysia, central banking policy being applicable only to the Federation of Malaya before this. These were reviewed to apply to all banks in Malaysia. The minimum reserve ratio was changed from 4% to 3½% with effect from February, 1965. On the other hand, the minimum liquidity ratio was modified from 25% to 20%. Another important change was in the definition of the composition of assets that could be included in the computation of the liquidity ratio. In the old definition liquid assets that were allowed to be included in the computation were :

(a) Treasury bills
(b) Other local liquid assets
(c) Government securities, with maturities longer than three months.
(d) Certain foreign liquid assets.

With respect to the Government securities, the amount was limited to 5% of deposit liabilities.

The new definition included the following :-

(a) Local liquid assets,[9] including Treasury bills,
(b) Government securities, with maturities longer than 3 months.

The composition of the local liquid assets should not be less than 10% of deposit liabilities, One notable component was missing, though and these were foreign liquid assets. The new change were to be effective in Septamber, 1965. In the meantime, banks could either follow the old or the new liquidity standards. It should be noted in passing that a further chage was made to the liquidity ratio in June, 1965. By this change, housing loans to individuals and approved housing institutions (subject to a maximum of 10% of the savings deposits of banks) could be included in the computation of the ratio. This was done to encourage banks to activiate their savings deposits by lending to finance housing projects.

What were the effects of these changes? First, the asset structure of the banking system in Malaysia and Singapore had changed to the extent that bank holdings of local liquid assets, especially Treasury bills had increased substantially. Second, there was a decline in the net foreign assets of the banking system.

Owing to the separation of Singapore from the Federation of Malaysia and the failure of the Malaysia-Singapore currency negotiations, new monetary measures were undertaken by the Central ~~xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx~~

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9 Include also Malayan currency, Balances at Bank Negara (except statutory reserves), net balances with other banks, net money at call and inland bills of exchange and promisory notes rediscountable at Bank Negara.

Bank. One of these measures was the revision of the composition of assets eligiable for inclusion in the minimum liquidity ratio of 20% which commercial banks in the whole of Malaysia observed. With effect from July, 31, 1967, only eligible Malaysian assets were allowed, subject to the conditions: Not less than 10% of deposit liabilities must be in actual liquid assets comprising:-

(a) Cash in hand,
(b) Balances with the Central Bank (excluding statutory reserves),
(c) Net balances with other banks in Malaysia,
(d) Malaysian Treasury bills,
(e) Government securities longer than 3 months' maturity,
(f) Housing loans to individuals and approved housing institutions (subject to not more than 10% of Savings deposits).

The effect of these modifications in the minimum liquidity ratio was that commercial banks' holdings of local assets, especially Treasury bills, expanded during 1967. By the end of 1967, $437.8 million worth of Treasury bills washeld, an addition of $212.2 million compared to that of 1966. The other assets increased to $421.3 million an increase of $85.5 million compared to that of 1966.

The liquidity ratio was again altered during 1968. This new change was to encourage banks to channel funds from savings deposits into longer-term government securities and housing loans, since savings deposits were considered to be relatively stable and therefore suitable for long-term investment. Since October, 1968, commercial banks were required to hold at least 50% of their savings deposits in longer-term securities and in the form of housing loans to individuals and approved financial intermediaries. With this change, the minimum liquidity ratio of 20% now applied to all deposits, except savings deposits, with the condition that cash, net balances, money at call and Treasury bills should at least amount to 10% of such deposits.

Interest Rate Policy

Many central banks possess and exercise the power of control over bank interest rates, both on advances and deposits. Such power may be thought desirable for a variety of reasons as a form of control over monopolistic pricing of bank credit, to keep the cost of credit in general or, for particular purposes, to inhibit excessive competition for deposits, or to give some protection to indigenous banks against competition from powerful foreign banks. In Malaysia, interest rate policy is formulated to "influence the credit situation to the advantage of the Federation (of Malaya)". Before 1959, the Malayan Exchange Banks' Association in collaboration with the Government established minimum rates of interest on advances that their members could charge. With the establishment of the Bank, the Malayan Exchange Banks' Association agreed to consult with it in respect of rates on advances. As regards interest rates on deposits, there was no similar arrangement. Thus, the Bank decided to impose maximum interest rates on deposits in order to prevent excessive and wasteful competition for deposits and a distortion of other rates, especially rates on Treasury bills and Treasury deposit receipts.

There are one or two points to note about the interest rates structure in Malaysia. There tend to be some correlation between the local interest rates and the British Bank Rate. This is inevitable, especially before the establishment of Bank Negara Malaysia, because of a number of factors: Malaysia then was on the Sterling Exchange Standard, there was and still is a close financial and trading link with Britain and there was and still is free movement of funds between Malaysia and the rest of the sterling area countries. These factors still apply in this country now. Yet, with the establishment of Bank Negara Malaysia, the Bank has attempted to have an independent interest rate structure here. The idea is to keep interest rates appropriate to domestic needs and to keep them in line with international trends. This independence was shown when the United Kingdom bank rate was raised from 5% to 7% in July, 1961. Malaya's Central Bank at that time thought it necessary to follow suit by raising the local fixed deposit rates of commercial banks from 4% to 5% in order to stem the outflow of funds to the United Kingdom. The Treasury Bills discount rates were accordingly raised from 4% to 5%. Similarly, commercial bank lending rates were also increased from 6% to 7%. However, when the United Kingdom Bank Rate was reduced to 6½% in October and further reduced to 6% in November of that year, no action was taken by the Central Bank just to be independent as it were. Another point to note is that all along interest rates in Singapore have been the same as those in Malaysia.

Let us now examine some of the changes in the interest rate structure, in which Bank Negara Malaysia has been instrumental in bringing about such adjustments. Table 4-1 and Table 4-2 show the changes in the Malaysian interest rate structure since 1959.

During the first year of its operation, it was noted by Bank Negara Malaysia that commercial banks allowed an unduly high rates of deposit interest rates to attract deposit funds from competitors resulting as we have seen in distortions in the structure of interest rates and what was more important, resulting in an embarrassing situation for the government in respect of the government's shorter-term securities. In view of this, the Bank suggested to the Malayan Exchange Bank's Association to move towards a rationalisation of deposits interest rates. The measure adopted by the Bank was to impose a maximum of 3½% fixed deposit rate for 3 and 6 months' deposits and 3¾% for 9 and 12 months' deposits.

The Central Bank implemented a new direction in policy regarding interest rates in 1962. Malaya at that time was experiencing a deteriorating balance of payments position brought about by declining commodity prices in the world market. To improve the balance of payments position it was suggested that the private sector should increase their rate of capital investment.

Table 4-1

## Commercial Banks

### Interest Rates

( % per annum )

| Date of change | Fixed Deposits (months) | | | | Savings Deposits[1] | Minimum Advances Rate against[3] | | |
|---|---|---|---|---|---|---|---|---|
| | I | 3 | 6 | 9-12 | | Govt. Securities etc[2] | Stocks and Shares | Properties |
| 1959 Oct. 1 | - | 3½ | 3½ | 3¾ | 2½ | 5 | 5½ | 6 |
| 1960 Jul. 1 | - | 4 | 4 | 4 | 2½ | 6 | 6½ | 7 |
| 1961 Jul. 28 | - | 5 | 5 | 5 | 2½ | 7 | 7½ | 8 |
| Aug. 10 | - | 5 | 5 | 5 | 2½ | 7 | 7½ | 8 |
| 1962 Feb. 2 | - | 4½ | 4½ | 4½ | 2½ | 6½ | 7 | 7½ |
| Feb. 15 | - | 4½ | 4½ | 4½ | 2½ | 6½ | 7 | 7½ |
| Aug. 30 | - | 4 | 4 | 4 | 2½ | 6¼ | 6¾ | 7¼ |
| 1964 Jan. 1 | 2 | 4 | 4 | 4 | 2½ | 6¼ | 6¾ | 7¼ |
| Nov. 25 | 2½ | 5 | 5 | 5 | 2½ | 7 | 8 | 8 |
| 1965 Aug. 1 | 2½ | 5 | 5 | 5 | 3 | 7 | 8 | 8 |
| | | | | | | General Rate | Preferential Rate[4] | |
| 1966 Oct. 1 | 2½ | 5 | 5 | 5 | 3 | 7½ | 7 | |
| 1967 Nov. 20 | 2 | 5½ | 5¾ | 6 | 3 | 8 | 7½ | |
| 1968 May 1 | 3 | 5½ | 5¾ | 6 | 3½ | 8 | 7½ | |

Source : Bank Negara Malaysia, Quarterly Economic Bulletin, Vol.I No.4 December, '68.

Note: 1 The Post Office Savings Bank paid the same rate of interest on deposits until April 30, 1968. As from May 1, 1968, the Post Office Savings Bank's interest rate was increased to 4% p.a.

2 Include advances against Municipal securities and commodities.

3 With effect from October 1, 1966, the minimum advances rates against government securities, stocks and shares and property were replaced by the general rate and the preferential rate.

4 The preferential rate applies to advances to Central and State Governments and statutory authorities and advances against Govt. and Municipal securities and against local agricultural produce.

Table 4-2.

## Interest Rates on Government Securities

( % per annum )

| Date | Malaysian Treasury Bills[1] Discount Rate | | | | Central Government Securities [2] | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 3 Months | 6 Months | 9 Months | 12 Months | 2 years | 3 years | 5 years | 7 years | 16 - 20 years |
| 1961 Feb. 20 | 4 | 4 | 4 | 4 | - | - | $4\frac{3}{4}$ | - | $5\frac{1}{2}$ |
| Aug. 10 | 5 | 5 | 5 | 5 | - | - | - | - | - |
| Sept. 25 | 5 | 5 | 5 | 5 | - | - | - | - | $5\frac{1}{2}$ |
| 1962 Feb. 15 | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | - | - | - | - | - |
| Apr. 16 | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | - | - | 5 | - | $5\frac{1}{2}$ |
| Aug. 30 | 4 | 4 | 4 | 4 | - | - | - | - | - |
| Sept. 3 | 4 | 4 | 4 | 4 | $4\frac{1}{2}$ | - | 5 | - | $5\frac{1}{2}$ |
| 1963 Feb. 18 | 4 | 4 | 4 | 4 | $4\frac{1}{2}$ | - | 5 | - | $5\frac{1}{2}$ |
| June 17 | 4 | 4 | 4 | 4 | - | - | - | - | $5\frac{1}{2}$ |
| Dec. 16 | 4 | 4 | 4 | 4 | $4\frac{1}{2}$ | - | 5 | - | $5\frac{1}{2}$ |
| 1964 Mar. 24 | 4 | 4 | 4 | 4 | - | - | - | - | $5\frac{1}{2}$ |
| Aug. 12 | 4 | 4 | 4 | 4 | $4\frac{1}{2}$ | - | 5 | - | $5\frac{1}{2}$ |
| Nov. 25 | 5 | 5 | 5 | 5 | - | - | - | - | - |
| Dec. 2 | 5 | 5 | 5 | 5 | - | - | - | - | 6 |
| 1965 Mar. 15 | 5 | 5 | 5 | 5 | 5 | - | $3\frac{1}{4}$ | - | $5\frac{3}{4}$ |
| Jul. 14 | 5 | 5 | 5 | 5 | - | - | - | - | $5\frac{3}{4}$ |
| Nov. 26 | 5 | 5 | 5 | 5 | - | $5\frac{1}{8}$ | - | - | $5\frac{3}{4}$ |
| 1966 Apr. 18 | 5 | 5 | 5 | 5 | - | - | $5\frac{1}{4}$ | - | $5\frac{3}{4}$ |
| Jul. 12 | 5 | 5 | 5 | 5 | - | $5\frac{1}{8}$ | - | - | $5\frac{3}{4}$ |
| Dec. 12 | 5 | 5 | 5 | 5 | - | $5\frac{1}{8}$ | - | - | $5\frac{3}{4}$ |
| 1967 Mar. 27 | 5 | 5 | 5 | 5 | - | - | $5\frac{1}{4}$ | - | $5\frac{3}{4}$ |
| Aug. 15 | 5 | 5 | 5 | 5 | - | - | - | $5\frac{1}{4}$ | $5\frac{3}{4}$ |
| Nov. 20 | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | - | - | - | - | - |
| Dec. 15 | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | - | - | 6 | - | $6\frac{1}{4}$ |
| 1968 Mar. 15 | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | $5\frac{1}{2}$ | - | - | 6 | - | $6\frac{1}{4}$ |
| June 10 | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $4\frac{1}{2}$ | $5\frac{1}{2}$ | - | - | - | - | - |
| Aug. 1 | 4 | $4\frac{1}{2}$ | 5 | $5\frac{1}{2}$ | - | - | - | - | - |
| Aug. 12 | 4 | $4\frac{1}{2}$ | 5 | $5\frac{1}{2}$ | - | $5\frac{3}{4}$ | 6 | - | $6\frac{1}{4}$ |
| Dec. 2 | 4 | $4\frac{1}{2}$ | 5 | $5\frac{1}{2}$ | - | $5\frac{3}{4}$ | 6 | - | $6\frac{1}{4}$ |

1 Dates refer to dates of change.

2 Dates refer to dates of issue

Source: Bank Negara Malaysia, Quarterly Economic Bulletin Vol. I No.4, December 1968, pg. 54.

One way to encour age private investment was to lower the cost of credit. Bank Negara Malaysia therefore suggested to the commercial banks, the suppliers of credit, to reduce their borrowing and lending rates. The commercial banks agreed to do this. There was a general downwards revision of the interest rate structure in 1962, which persisted all through 1963.

In 1964, there was again a change in the interest rate policy of the Central Bank. The key interest rates were raised in the banking system in order to take account of rising rates in the major international money markets and at the same time to dampen the expansion of bank credit. In addition, the Bank also advised the commercial banks to channel more of their funds into productive projects and to reduce their advances for speculative purposes by means of directives.

In 1965, there were no further issuance of directives to commercial banks regarding deposits and advances rate of interest. However, the savings interest rate of the Post Office Savings Bank and the savings deposits rate of commercial banks was increased from $2\frac{1}{2}\%$ to 3%, in order to encourage savings from the public.

Two new monetary measures were introduced in 1967, one being the upward revision of interest rates and the other the change in liquidity ratio. It must be remembered that 1967 was marked by two important events in the monetary situation in Malaysia. Bank Negara Malaysia implemented its nonopoly rights of currency issue and the devaluation of the British Pound were the two events mentioned. The interest rate structure was revised upwards in November, 1967 due to two main reasons. First, it was revised in order to bring local interest rates in line with the rising trend of interest rates in the international money markets and second, to rationalise the interest rate structure, that is, the rates were differentiated according to the period of the deposits. With regards to the maximum interest rates for fixed deposits of 3, 6, 9 and 12 months' duration, the rates were adjusted from a flat rate of 5% in 1966 to $5\frac{1}{2}\%$, $5\frac{3}{4}\%$, 6%, and 6% respectively. The one month deposit rate was increased from $2\frac{1}{2}\%$ to 3%. On the other hand, the minimum advance interest rates against general bank advances were raised by $\frac{1}{2}\%$ to 8%. The minimum advance rate against advances to Government and public authorities, government and municipal securities and local government was raised from 7% to $7\frac{1}{2}\%$.

Later, in 1968 the Treasury bills discount rates were adjusted downwards twice during that year, once in June and later in August. The June adjustment was to meet an inflow of funds arising from uncertainties which were causing a sharp increase in the Treasury Bills issue. The August adjustment, on the other hand, was to reduce the danger of any sudden shift of substantial funds from Treasury bills, to lengthen the maturity of the Central Government's short-term debt, and at the same time to rationalise the rate structure for Treasury Bills.

Interest rates in Malaysia have to be kept low to encourage private investment and to keep the cost of Government borrowing as low as possible. Investment, either public or private, is essential to the economic development of this country. Further, due to the absence of exchange control in the sterling area countries, interest rates here have to be competitive internationally as well. Normally, interest rates in Malaysia have followed the United Kingdom rates for fear of outflow of funds to the British money and capital markets. Funds are very much required domestically, for economic development purposes.

In addition to the above monetary tools used by Bank Negara Malaysia, it is also empowered to make recommendations to the commercial banks on their lending policies. This 'qualitative advance policy' has so far not been formally exercised. However, it has indirectly carried out this policy through liquidity arrangements imposed on the commercial banks; it may be remembered that banks are required to hold not less than 50% of their savings deposits to total deposits be used to finance housing projects.

The aforementioned Central banking policy measure undertaken by the Bank during the past few years were "directed not so much to the deliberate management of the money and credit situation, the conventional sense of monetary policy, but rather towards strengthening of the framework for effective measures to be taken when the need arises".[10] So far, the Central Bank has not been really tested with regards to the effectiveness of its monetary measures. There were no serious inflation or deflation in Malaysia to really gauge the effectiveness of its central banking policy. However, should these happen the Central Bank is fully prepared to meet the challenge.

Developmental Functions

The developmental functions of the Bank are concerned with the sound growth of banking and other financial institutions and to assist in economic development wherever and whenever possible. Theoretically, the scope of these functions for Bank Negara Malaysia has been discussed in the previous sections of this Chapter.

Most of the Central Bank's efforts so far in this field have been in promoting the development of an organised money and capital markets in Malaysia. The promotion of economic development role has not been fully undertaken by the Bank, but in the future it is hoped that such efforts are forthcoming. The development of the money and capital market is so important and essential for the bank because it is generally recognised that an organised and developed money market, in particular, is necessary in order that Central Bank policies especially of the quantitative kind (e.g. Bank Rate and open market operations) are to be significantly operative. For example, an effective money market dealing in local bills would enable the Central Bank to manipulate interest rates, by making money abundant or scarce through its own purchases or sales.

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10 Bank Negara Malaysia: Annual Report and Statement of Accounts, 1964 Pg.2.

What is a developed money market? "A money market provides facilities for the quick and dependable transfer of short-term debt instruments used to finance the needs of business, government, agriculture and consumers." [11] Insitutionally therefore, a developed money market must have an effective central bank to serve as the ultimate source of liquidity and well developed commercial banking system as the main suppliers and demanders of loanable funds. Like other markets, there should exist a sufficient demand for the type of services that a money market can provide. There must also exist a sufficiently large supply of temporarily idle funds which are seeking short-term investment opportunities. At the same time there must be a demand for these funds, either from commercial banks in order to adjust their liquidity positions, or from the government when it chooses to finance its activities, by issuing short-term securities.

The next question to ask is does this institutional set-up exist in Malaysia? The commercial banking system is comparatively well developed. Banking awareness among the public is growing, especially so in urban areas. However, the money market and the capital market are still not so well developed and organised as in Western countries. Nevertheless, with the estasblishment of the Bank in 1959 the scope has been broadened somewhat. After a decade in existence, the Bank managed to foster the growth of money market and a Stock Exchange which is active today to cate for the market of private capital. The market for Government medium and long-term securities is also quite active.

It is time now to discuss the development of these markets, which Bank Negara Malaysia undertake in its development efforts for a sound growth of cinancial institutions. We divide the discussion into three headings for convenience :-

(a) Money Market
(b) Capital Market
(c) Commercial Banks

## Money Market

The money market in Malaysia "seems to consist of two submarkets - one recognised and painstakingly cultivate and encouraged by the Central Bank and the other, an embarrassment to the authority and ignored by it." [12] What is referred to in the former is the

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11 Herbert E. Dougall, "Capital Markets and Institutions" in Foundation of Finance Series - Prentice Hall.

12 Sumitro Djojohadjikusumo - Trade and Aid in South East Asia - Malaya and Singapore : University of Malaya Co-operative Bookshop, 1969 Pg. 144.

market in short-term funds and Treasury bills and what is referred to in the latter is the market in inter-bank funds. The market is inter-bank funds is quite active this past year or two but viewed with disfavour by the Central Bank, since borrowers are mostly foreign banks and lenders the local banks. This defeats the purpose of making the foreign banks as "importers" of foreign funds into the country.

In order to properly operate a money market, there must be some short-term debts instruments to be the basis for buying and selling among demanders for and suppliers of such intrucments in the market. Bank Negara Malaysia has chosen to utilise the Malaysian Government Treasury Bills of 3, 6, 9 and 12 months maturities as the basis for the money market activities here. The positive steps taken by the Central Bank in promoting the growth of the market are: first, to encourage commercial banks to hold Treasury Bills as part of their liquidity requirements; second, to offer rediscounting facilities primarily for Commercial banks, but also to other financial institutions, and third, to participate in the Treasury Bills market itself. The rediscounting facilities are offered to commercial banks and other institutions at the rate of 1/8% above the current Treasury Bills rate, with a maximum penalty of ½%. Between 1961 and 1968, the volume of transactions in Treasury Bills has grown substantially. Table 4-3 shows the operations in Treasury Bills of the Central Bank. It may be noted at the outset that the Central Bank also participated in the Singapore Government Treasury Bill Market, when Singapore was part of Malaysia. In 1964 the Bank purchased and rediscounted $23.3 million worth and sold $17.6 million worth of Singapore Treasury Bills. The amounts rose to $58.1 million and $60.8 million respectively in 1965. The Bank ceased operations in Singapore bills sometime after Singapore left Malaysia. As a result of increased activities in the Treasury Bills market, the statutory ceiling on the issue of Treasury Bills has been raised three times since 1961. It started off at $150 million, then doubled to $300 million in 1964. A year later the statutory ceiling was again raised to $600 million, until it reached the present limit of $1,000 million, which was increased in 1966.

The amount of Treasury Bills outstanding from 1963 to 1968 is shown in Table 4-4.

The market has grown to its present size primarily because of increased holdings of this liquid asset by the Commercial banks in the country in order to satisfy the present liquidity requirements made by the Central Bank. For exmaple, in 1966 out of the total of $578.1 million Treasury Bills outstanding, $415.9 million or 71.9% were held by the commercial banks. In 1967, out of $643.8 million outstanding, the banks held $437.8 million or 68%. One result of increased activity in Treasury Bills has been a reduction in the holding of foreign assets by commercial banks. The other result has been a marked decrease in the drawing down of the Government's accumulated overseas assets since government borrowing to offset a deficit may now be done in the local money market.[13]

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13 Bank Negara Malaysia : Annual Report and Statement of Accounts, 1965 - Pg. 34.

Table 4-3

Central Bank Operation in Malaysian Treasury Bills 1961 - 1968 ( $ million )

| Period (end of) | Total Rediscounted | Discounted for: Commercial Banks | Discounted for: Other Institutions | Bank's sale of T/Bills from own Portfolio to: Commercial Banks | Bank's sale of T/Bills from own Portfolio to: Other Institutions | Bank's Purchase of T/Bills. |
|---|---|---|---|---|---|---|
| 1961 | 20.9 | 17.1 | 3.8 | 50.3 | 3.0 | 55.5 |
| 1962 | 7.2 | 7.2 | - | 29.0 | - | 61.0 |
| 1963 | 43.8 | 41.84 | 1.96 | 71.75 | 9.01 | 93.94 |
| 1964 | 132.2 | 97.2 | 35.0 | 90.9 | 63.5 | 97.6 |
| 1965 | 285.9 | 171.3 | 114.6 | 121.5 | 112.2 | 139.5 |
| 1966 | 572.4 | 402.7 | 169.7 | 169.7 | 61.5 | 256.8 |
| 1967 | 709.8 | 469.6 | 240.2 | 240.2 | 80.8 | 262.7 |
| 1968 | 830.2 | 499.8 | 330.4 | 330.4 | 229.2 | 151.6 |

Source: Bank Negara Malaysia: Annual Report and Statement of Accounts, 1961 - 1968.

Note: "Other Institutions" include the Short Deposits (Malaysia) Limited.

Table 4-4

Amount of Malaysian Treasury Bills Outstanding (1963 - 1968)

($ million )

| Period (End of) | Amount Outstanding |
|---|---|
| 1963 | 148.2 |
| 1964 | 224.3 |
| 1965 | 449.8 |
| 1966 | 578.1 |
| 1967 | 643.8 |
| 1968 | 778.6 |

Another significant development in the money market was the formation of a discount house, the only one of its kind in Malaysia so far, towards the end of 1963. The Short Deposits (Malaysia) Limited, as the discount house is called, is supervised in its operation by the Central Bank. It is given rediscounting of bills and lender of last resort facilities by the Bank. All funds held must be invested in Treasury Bills and other short-term government securities. Its services, though receiving mild reception at first from commercial banks and other financial instituions, are now increasingly being used by the latter. The establishment of the discount house is a step forward towards institutional specialisation in the money market. The table below shows an aspect of its growth since its establishment:

Table 4-5

Short Deposits (Malaysia) Limited

Amount of Deposits Held - 1964 - 1968

($ million)

| Period (End of) | Total Deposits | Range of Interest Rate Charged on Deposits (% p.a.) |
|---|---|---|
| 1964 | 19.4 | 2 - 4 |
| 1965 | 39.4 | $2\frac{1}{2}$ - $5\frac{1}{4}$ |
| 1966 | 37.0 | $2\frac{1}{2}$ - 5.1/16 |
| 1967 | 33.4 | $2\frac{1}{4}$ - 5.1/8 |
| 1968 | 37.5 | $2\frac{3}{4}$ - $3\frac{3}{4}$ |

Source: Bank Negara Malsysia, Annual Report and Statement of Accounts, 1964 - 1968.

## Capital Market

Besides being responsible for the development of the money market, the Central Bank is also charged with the setting up of an organised capital market, which is a source of funds for industry and long-term government borrowing. The capital market, theoretically is "the complex of institutions and mechanisms whereby intermediate-term funds (longer-maturity loans and corporate stocks) are pooled and made available to business, government and individual and where instruments that are already outstanding are transferred. As in the case of the money market, the markets are local, regional and national in scope." 14

14 Herbert E. Dougall op. cit.

In Malaysia, actually there are two sub-markets of the capital market: there is a market for long-term Government securities, dealt through the Central Bank, being managers of the local funded debts of the Government; and there is the share and debenture markets, dealt through the Stock Exchange of Malaysia and Singapore.[15]

Initially, the development of the Capital market of Malaysia washandicapped by the shortage of marketable securities and the absence of an organised stock exchange in Kuala Lumpur. The scope of trading in whatever securities that were available was also limited. Most of the holdings of Government securities were held by the Employees' Provident Fund and other institutional investors such as the Post Office Savings Bank and other Provident and Trust Companies. This led to some sort of a "captive" market in government securities.

Some positive steps had been taken by the Central Bank of Malaysia to develop the market in long-term government securities. Firstly, it suggested the widening of the maturity base of the government securities, especially providing for more short-term securities. It was for this reason that the Government, through the suggestion made by the Central Bank, introduced 2-year and 5-year securities in 1961. They proved quite popular among commercial banks and insurance companies and thus helped widen the spread of investors, other than the Employees' Provident Fund. Secondly, stamp duty in the transactions of government securities was waived, thus easing transactions. Thirdly, government securities could be used in tendering payments of estate duties. Fourthly, there was a provision of advance subscription facilities and lastly, higher rates of commission were paid to brokers to aim at increasing the attractiveness of the government securities to investors. All these measures had been implemented by the Government on the suggestions of the Central Bank. As a result of the above measures, there was an increased involvement of commercial banks, insurance companies and other financial institutions in the market for government medium and long-term securities.

Table 4-6 below shows the subscriptions of medium and long-term securities from 1963 to 1968, indicating the amounts floated. The interest rates structure on government securities can be found in Table 4-1 and Table 4-2 above.

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15 Former name : Malayan Stock Exchange

Table 4-6

Malaysian Government

Medium and Long-Term Securities.

Amounts of Loans Floated

1963 - 1968.

($ million)

| Year | Loan Number | Amounts of loans floated |
|---|---|---|
| 1963 | 1 | 135.0 |
| | 2 | 40.5 |
| | 3 | 47.7 |
| 1964 | 1 | 46.0 |
| | 2 | 100.0 |
| | 3 | 25.0 |
| 1965 | 1 | 88.0 |
| | 2 | 80.0 |
| | 3 | 80.0 |
| 1966 | 1 | 82.5 |
| | 2 | 95.5 |
| | 3 | 109.9 |
| 1967 | 1 | 188.0 |
| | 2 | 115.0 |
| | 3 | 177.0 |
| 1968 | 1 | 118.5 |
| | 2 | 136.0 |
| | 3 | 150.0 |

It was noted at the beginning of this discussion on the government securities market that the Employees' Provident Fund was the main subscriber to Central Government Loans. For the period 1965 - 1968, the situation still remains more or less the same as the following Table 4-7 shows. However, there is clearly a marked decrease in the subscriptions of the E.P.F. since 1965 - in 1965 it was 64% of total subscriptions and later declined to 36% in 1968. In 1968, it took a big fall because of the reduction in its capacity to invest owing to heavy withdrawals by contributors who are allowed to take out one-third of their credit balances at the age of 50. Commercial banks have shown a tendency to subscribe progressively greater amount of funds in successive years, a good sign indeed. The big increase in 1968 in the Post Office Savings Bank's subscription compared to 1967 was due to the re-channelling of foreign securities to local securities. The other financial institutions show very little change for the period 1965 - 1968.

Table 4-7.

Subscription to Central Government Loans

(1965 - 1968)

| Period | EMPLOYEES' PROVIDENT FUND | | POST OFFICE SAVINGS BANK | | COMMERCIAL BANKS | | OTHER PROVIDENT AND TRUST FUNDS | | OTHER | | TOTAL | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | $ Million | $ Million | $ Million | % of Total | $ million | % of Total | $ Million | % of Total | $ Million | % of Total | $ Million | % of Total. |
| 1965 | 157.60 | 64 | 28.31 | 11 | 15.75 | 6 | 11.49 | 5 | 34.85 | 14 | 248.00 | 100 |
| 1966 | 162.55 | 57 | 30.01 | 10 | 18.31 | 6 | 16.07 | 6 | 60.96 | 21 | 287.90 | 100 |
| 1967 | 234.21 | 49 | 29.93 | 6 | 55.73 | 11 | 17.46 | 4 | 142.67 | 30 | 480.00 | 100 |
| 1968 | 146.05 | 36 | 50.81 | 12 | 85.29 | 21 | 18.91 | 5 | 103.44 | 26 | 404.50 | 100 |

Source : Bank Negara Malaysia, Annual Report and Statement of Accounts, 1968.

Besides the government securities market, there is also the shares and debentures market conducted by the Scotk Exchange, which was established in Kuala Lumpur in 1961. Its early development has been under the care of the Central Bank of Malaysia. In its early years, its operations were handicapped by such factors as the absence of a proper trading room and the restriction of hours of trading. The Stock Exchange was housed in the Clearing House of the Central Bank and as such the Exchange could only use the place when there were no bank clearings to be done. However, these conditions were removed when it moved to a new trading room which was more specious and conducive to efficient operation on June 15, 1962. Other reforms were also carried out such as the introduction of standards for the listing of companies and the publication of a regular Stock Exchange Gazette, the installation of direct telephone communication system between the Kuala Lumpur and Singapore markets and the introduction of new rules and bye-laws to impose stricter requirements of companies seeking a listing and the appointment of a full-time manager to supervise the efficient working of the Stock Exchange. A most important reform was the establishment of branch share registers in Malaysia of "companies incorporated in the United Kingdom whose main business is in the Federation of Malaya, and whose shares are actually traded locally".[16] This has helped to increase the turn-over on the stock exchange.

The following Table 4-8 shows the funds raised by New Issue in the Stock Exchange from 1961 to 1968.

Table 4-8

Stock Exchange of Malaysian and Singapore
Funds raised by New Issues.

(1961 - 1968)

| Year | No. of Issues | $ Million |
|---|---|---|
| 1961 | 3 | 15.6 |
| 1962 | 3 | 26.9 |
| 1963 | 13 | 65.7 |
| 1964 | 12 | 43.8 |
| 1965 | 1 | 4.0 |
| 1966 | 5 | 32.6 |
| 1967 | 4 | 22.2 |
| 1968 | 5 | 28.4 |
| | Total .. | $239.2 |

Source: Bank Negara Malaysia, Annual Report and Statement of Accounts, 1961-68.

[16] Bank Negara Tanah Melayu, Annual Report and Statement of Accounts, 1961 - Pg.21

The most striking feature of the new issues market was the heavy over-subscription for new issues on the Stock Exchange of Malaysia and Singapore. A large proportion was probably accounted for by multiple application. Nevertheless, it indicated the existence of large amounts of domestic capital available for investment.

The activity in the new issues market was also largely the result of the Government's policy to encourage foreign firms to allow local participation in their business as well as the incentives given for the establishment of new industries. Since its formation in 1961, the Exchange had facilitated the transfer of about $240 million to finance development in the private sector.

With the operation of a stock exchange and its attendant institutions, such as investment dealers and brokers, those with excess funds are more willing to invest in financial assets since regular transactions on the exchange enable securities to be brought and sold easily and efficiently.

In conclusion, it should be understood that the Central Bank of Malaysia's active role in the development money market is not without reason. A sufficiently big market could be expected in the future to be an area in which it could implement the traditional open market operations to influence credit situation, to the advantage of the country. Besides the market for short-term bills hasother uses for the Bank. Because of the existence of the market, the Bank has directed banks to hold liquid assets in the forms of Treasury Bills,of course. Thus commercial banks investments can be kept in the country, rather than placed elsewhere especially in London, as has been the practice of banks in the past. All signs show that prospects for the growth of the money market are bright indeed. Perhaps, more discount houses could be formed, leading to a situation like the London Money Market.

## Commercial Banks

An important aspect in the developmental function of Bank Negara Malaysia is directed towards the growth of a sound commercial banking system in the country. It is generally recognised that the banking system in Malaysia is well developed, with a Central Bank at the apex and a system of commercial banks at the base. However, there is much that the Bank could do to improve the quality and quantity of banking services in the country.

Bank demand deposits have constituted a very important component of the money supply, which is defined in the narrow sense as demand deposits and currency held by the private sector. The present proportion of the two components is roughly 52% to 47% as compared to 49% to 51% in 1963.

The number of banking offices has steadily grown since the inception of the Bank in 1959. Table 4-9 traces the growth of banks from 1959 to 1968. The total number of banks rose from 26 in 1959 to 38 in 1968 and the number of banking offices from 111 to 324.

Table 4-10

Distribution of

Commercial Banking Offices in Malaysia.

| | Domestic Banks End of: | | Foreign Banks Singapore End of: | | Foreign Banks Other Countries: End of: | | Total End of: | |
|---|---|---|---|---|---|---|---|---|
| | 1967 | 1968 | 1967 | 1968 | 1967 | 1968 | 1967 | 1968 |
| Johore | 18 | 18 | 8 | 9 | 2 | 2 | 28 | 29 |
| Kedah | 10 | 10 | 1 | 2 | 2 | 2 | 13 | 14 |
| Kelantan | 5 | 5 | 2 | 2 | 2 | 2 | 9 | 9 |
| Malacca | 7 | 7 | 3 | 3 | 4 | 4 | 14 | 14 |
| Negri Sembilan | 12 | 12 | 2 | 2 | 3 | 3 | 17 | 17 |
| Pahang | 7 | 7 | 3 | 4 | 8 | 8 | 18 | 19 |
| Penang | 19 | 20 | 8 | 8 | 10 | 10 | 37 | 38 |
| Perak | 27 | 27 | 7 | 7 | 9 | 9 | 43 | 43 |
| Perlis | 1 | 1 | - | - | 1 | 1 | 2 | 2 |
| Sabah | 4 | 5 | 4 | 6 | 13 | 13 | 21 | 24 |
| Sarawak | 13 | 14 | 2 | 2 | 9 | 9 | 24 | 25 |
| Selangor | 36 | 37 | 15 | 15 | 30 | 31 | 81 | 83 |
| Trengganu | 4 | 4 | 1 | 1 | 2 | 2 | 7 | 7 |
| Total ... | 163 | 167 | 56 | 61 | 95 | 96 | 314 | 324 |

Source: Bank Negara Malaysia, Annual Report and Statement of Accounts, 1968.

On the deposits side, there has also been a marked increase since 1961. In 1961, the total deposits of the commercial banking system was $1,186 million, but in 1968 it more than doubled to $2,670 million. The deposits of Commercial Banks by type are shown in Table 4-12.* The greater proportion of total deposits still goes to fixed deposits. What contributed to the growth of these bank deposits as a whole? Two factors may be given. These are the rise in banking facilities and the rise in the level of income, especially in areas where there were no banks before. Some of the banks in the outlying areas, in fact, are no more than collecting centres of deposits and mobilisers of small savings.

One feature of the commercial banking system is the continued dominance of three British Banks (Chartered Bank, Ltd., Hongkong and Shanghai Banking Corporation and Mercantile Bank, Ltd.) and one or two local Chinese banks (one of these is the Overseas-Chinese Banking Corporation). It is hoped that a much wider competition might improve the quality of banking and also the quantity, through wise liecensing of new banks by the Bank Negara.

To sump up, the developmental efforts of Bank Negara Malaysia with regards to commercial banks are at least in three areas. Firstly, the Bank could help the establishment of banking facilities where they are actually needed, especially rural areas. Secondly, it could influence the pattern of bank lending, through qualitative advance policy, in line with government economic policy such as financing industrialisation. Thirdly, it could help in improving the banking know-how of the banking community by providing training facilities to bank officers, such as a residential training course in modern money and banking.

* See page 116.

Table 4-11

Commercial Banks

Classification of Loans and Advances

(end of Period)

| | 1963 | | 1964 | | 1965 | | 1966 | | 1967 | | 1968 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | $ m. | % of Total | $ m. | % of Total | $ m. | % of Total | $ m. | % of Total | $ m. | % of Total | $ m. | % of Total |
| Agriculture | 114.2 | 5.9 | 126.4 | 5.9 | 108.5 | 4.7 | 90.6 | 7.0 | 128.6 | 9.0 | 163.3 | 9.3 |
| Mining and Quarrying | 42.2 | 2.2 | 34.3 | 1.6 | 37.5 | 1.6 | 27.8 | 2.2 | 47.2 | 3.3 | 49.3 | 2.8 |
| Manufacturing | 186.8 | 9.6 | 282.8 | 13.1 | 331.4 | 14.4 | 192.5 | 15.0 | 213.4 | 14.9 | 320.3 | 18.2 |
| Construction | 110.2 | 5.7 | 140.4 | 6.5 | 163.7 | 7.1 | 93.7 | 7.3 | 142.6 | 10.0 | 158.7 | 9.0 |
| Commerce | 1,002.4 | 51.5 | 999.2 | 46.5 | 1,114.1 | 48.3 | 477.1 | 37.1 | 502.0 | 35.0 | 622.6 | 35.3 |
| Professional and Private Individuals | 306.2 | 15.7 | 344.1 | 16.0 | 331.6 | 14.4 | 222.3 | 17.3 | 232.8 | 16.2 | 275.9 | 15.6 |
| Others | 182.2 | 9.4 | 224.0 | 10.4 | 219.3 | 9.5 | 182.2 | 14.1 | 166.3 | 11.6 | 173.5 | 9.8 |
| Total .. .. | 1,994.2 | 100.0 | 2,151.2 | 100.0 | 2,306.1 | 100.0 | 1,286.2 | 100.0 | 1,432.9 | 100.0 | 1,763.6 | 100.0 |

Source: Modified from Bank Negara Malaysia Annual Reports, 1963 - 1968.

Table 4-12

Malaysia : Deposits of Commercial Banks by Type

($ million)

| Period: | Current $ | Current % of Total | Fixed $ | Fixed % of Total | Savings $ | Savings % of Total | Other $ | Other % of Total | Total |
|---|---|---|---|---|---|---|---|---|---|
| 1961 | 550 | 46 | 474 | 40 | 154 | 13 | 8 | 1 | 1,186 |
| 1962 | 576 | 46 | 485 | 39 | 182 | 14 | 12 | 1 | 1,255 |
| 1963 | 627 | 45 | 543 | 39 | 218 | 15 | 10 | 1 | 1,398 |
| 1964 | 665 | 43 | 600 | 39 | 257 | 17 | 10 | 1 | 1,532 |
| 1965 | 714 | 41 | 727 | 41 | 291 | 17 | 12 | 1 | 1,744 |
| 1966 | 795 | 45 | 842 | 43 | 340 | 17 | 5 | - | 1,982 |
| 1967 | 792 | 35 | 1,012 | 45 | 434 | 20 | 6 | - | 2,244 |
| 1968 | 920 | 35 | 1,260 | 47 | 484 | 18 | 6 | - | 2,670 |

Source: Modified from Bank Negara Malaysia, Annual Report and Statement of Accounts, 1966 and 1968.

CHAPTER V : CONCLUSION

## General

In this concluding chapter, we shall review the past achievements of Bank Negara Malaysia for the past ten years and at the same time we shall assess its future role in the formulation and implementation of monetary policy in the Malaysian context, in conjunction with the Government's overall economic policy.

Bank Negara Malaysia is comparatively young in relation to its counterparts in the Western developed world. Though young, it is nevertheless old in experience. Formed less than two years after the former Federation of Malaya achieved her independence in 1957, the Bank symbolised the expression of monetary independence of the new nation, and since then it has accumulated a fairly vast reservoir of experience and central banking traditions. With its formation the various monetary functions of the government such as the management of the government's domestic and foreign debts, the supervision of exchange control and the custody of foreign reserves came to be centralised into one body. Besides these, the Bank was also provided with the powers of currency issue, managing the government's accounts and acting as banker to commercial banks. In other words, the Bank was given the duty of a watch-dog: guarding the proper working of the country's monetary system. While central banks of the West acquired these functions through the slow process of evolution, Bank Negara Malaysia, like all other central banks of emerging nations was given them more or less at once through legislation by Parliament. However, the powers given to the Central Bank of Malaysia by Parliamentary legislation were rather limited; there was doubt as to whether the Bank could borrow within or outside the country; the powers of currency issue were held in abeyance until two years ago and more importantly the exchange rate for the currency to be issued when the Bank assumed the powers to do so was actually written into the law. All these reflected the cautious and hesitant beginnings of the Bank. The drafters intended that the Bank should be just a simple and automatic regulating agency of the Government and at the same time to be banker and financial adviser to the Government. Of course, all these have changed: the Bank now is a true central bank with all functions normally associated with central banks in operation.

Bank Negara Malaysia, as we already know, is the monetary instrument of the Government to ensure that the economic policy objectives of the Government are attained as far as monetary matters are concerned. How well has the Bank been able to shoulder such responsibilities? The past ten years have been marked by stability: stability in the political, social and economic fields.

Under such a climate of stability, part of which is, of course, monetary stability, the economy has grown to what it is now. If the per capita income can be taken as a measure of economic growth, Malaysia's growth rate is an enviable one indeed:

the per capita income was about $800 in 1958, but in 1969 it has risen to $980. The gross national product also has grown to more than $10 billion in 1968. Without an environment of monetary stability, this creditable rate of economic growth may not have been achieved. Of course, there is the other side of the picture: there are problems to be solved like, for example, the unemployment prblem, which is not too pressing a problem when we consider that Malaysia is endowed with vast tracts of undeveloped land waiting to be exploited. Bank Negara Malaysia is expected to help to bring about economic development through stability of the country.

What were the achievements so far attained by the Bank in the first ten years of its existence ?

The Bank Organisational Structure

Firstly, the Bank has succeeded in the establishment and the strengthening of the organisational structure of the Bank. In Chapters II and III, we saw that the Bank has managed to assemble a system of eight departments to perform the functions of central banking entrusted to it. That system was evolved through adaptation to changing circumstances over the years. As far as the present needs go, the departmental organisation of the Bank is suitable. Of course, when the Bank growas, further improvements have to be undertaken so that the Bank can perform its central banking functions satisfactorily. When the Bank first started operation, it had only 67 staff to run it. Now ten years later, the number of staff has risen to 508. This can be regarded as a measure of its growth. When central banking activities grow larger and larger, the number of staff will be increased accordingly. But mere numbers are not so important, it is the quality of the staff that counts. That is why the Bank has taken great efforts to train its staff on the finer points of central banking, so that the standard of central banking will be high. Bank Negara Malaysia undertakes this staff development in various ways as we had seen in Chapter II.

In terms of premises, the Bank has also grown. Now there is a network of 5 branches serving such centres as Kuala Lumpur, Penang, Johore Bahru, Kuching and Kota Kinabalu. The Bank's long-term plan is to open branches in every State capital in Malaysia. The reasons for this are to facilitate the issue of the Malaysian currency, to improve the banking system in all the large centres of the country and to assist state governments in economic planning work. A headquarters building is coming up in the Federal Capital to be a symbol of the "solidity and strength" of Malaysia's currency.

One word should be said about the Board of Directors. The Board has performed its job well. It has managed to formulate monetary policy to the advantage of the country.

Progess is also reflected in the notable building up of the Bank's own financial resources. The first statement of Assets and Liabilities of the Bank in 1959 showed that the total assets of the Bank amounted to only $125 million, of which 20 million was subscribed by the Government as paid-up capital. Ten years later, the position changed to the amazing figure of $1,400 million, an increase of 1000%[1]. With these resources the Bank can be more secure in monetary management of the country.

## Issue of Currency Power

Secondly, perhaps the most important achievement reached by the Bank was the assumption of its power to issue currency. With this power, the Bank became a true central bank. It is rather unique in the monetary history of this region that the Central Bank was not given this power right from the start, though provisions were made in the legislation for the Bank to have the power of currency issue. Monetary management, without control over the currency component of the money supply, will be a weak one; especially when currency constitutes about 50% of the total money supply of the country, although it is gradually decreasing in importance. The strength of the Central Bank -issued Malaysian dollar was solid. The $840 million in new curreny in circulation in early 1969 has the backing of $1,300 million in gold and foreign exchange held by Bank Negara. The $1,300 million is certainly more than the 35% minimum backing as required by Section 29 of the Central Bank of Malaysia Ordinance, 1958. The public can be rest assured that the strength of the Malaysian dollar will be adequately backed.

## Relationships with Commercial Banks

The third significant feature which marked the progress of the Bank is the relationship of the Bank with the Commercial banking system. In fulfilling its objectives of promoting monetary stability and a sound financial structure, and in influencing the credit situation to the advantage of Malaysia, the nature and scope of the relationship between the Central Bank and the commercial banks are of significant importance. The relationship betwen the commercial banks and the Central Bank in Malaysia involves above all, the administration of the laws governing banking business in the country. Various reviews had been undertaken to the legislation from time to time since 1958, to accommodate changing circumstances in commercial bank-central bank relationship. Two changes had been undertaken to the Banking Ordinance, 1958, resulting in the Banking (Amendment andExtension) Act, 1965 and the Banking and the Banking (Amendment) Act, 1968. The latest amendments which came into force on April, 4, 1968, included :-

(1) The Capital requirements of foreign banks operating in Malaysia were altered. Foreign banks are now required to hold net assets of not less than $2 million instead of "approved assets" in Malaysia as in the previous legislation. This requirement was to ensure that these banks operating here would have a continuous stake in the country by employing at least $2 million of their own funds in their operations in Malaysia.

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1 Straits Times - 27/1/1969

(2) A provision to enable the Central Bank to make regulations on the acquisition or holding by a commercial bank of shares of any company or of immoveable property and in respect of banks becoming a partner or proprietor in any firm with unlimited liability.

(3) Extension of powers of investigation of the Central Bank to subsidiaries of Banks.

(4) A new provision was also introduced requiring directors of banks to disclose to their boards of directors their interest in loans and advances granted by their banks. Banks are now required to submit regular returns to the Central Bank giving particulars of all loans and advances, both secured and unsecured, granted to certain categories of borrowers.[2]

These latest rounds of amendments met with strong representations from commercial banks. They considered them to be quite harsh on them. However, it should be remembered that these regulations are necessary in the interest of the national economy. This has lead the Governor to make a remark regarding this at the Tenth Anniversary Commemoration Dinner held on January 26, 1969 :

> To me, the fundamental question really is whether the banking community in our country recognises the true role of banks in the overall economic system of the country, particularly in the monetary field. My view is that once the banking community recognises that commercial banks play a key role in the progress and development of our country's economy, that a bank is an important institution for the purpose of mobilising the financial resources of the country, and that in fulfilling their function, the element of public confidence in the soundness of the bank's management is key factor, that the uses to which funds deposited in the banks by the public are vital to the progress and development of the economy as a whole, once the banking community recognises all these, resort to legislative and regulatory measures by the Government and the Central Bank could be reduced to the minimum. And the nature and scope of the relationship between Bank Negara Malaysia and the commercial banks may well then be different entirely.

Commercial bank-Central Bank relationship also comes in other forms. There is the relationship of the Bank as a banker is the commercial banks. This requires a certain degree of understanding and competence in purely commercial banking business, particularly on the manner in which it is conducted on the part of the Central Bank. The Bank has managed to carry out this function competently. The relationship with the commercial banks also involves close supervision and control over the operation of all commercial banks in the country. The Bank Supervision and Internal Audit Department of the Bank has done this job quite well and thus ensuring a sound banking system in the country.

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2 Bank Negara Malaysia: Annual Report and Statement of Accounts, 1968 - Pg. 24 - 25.

## Relationship with the Government

The fourth factor that marked the development of the Bank since 1959 is the relationship of the Bank with the Government. The kind of relationship with the Government is already familiar to us. They may be found in Part VI of the Central Bank of Malaysia Ordinance, 1958. It is obvious that there is a difference between the legal relationship as embodied in the Ordiance and the relationship in practice. The real relationship is, in effect, the personal relationships of the Governor and the Minister of Finance. This relationship is important because careful co-ordination of fiscal, monetary and banking policies in which the Bank will be called upon to play a leading part will be necessary to maintain the internal purchasing power and external stability of the Malaysian dollar and to achieve economic development with stability. The personal relationship between the Governor and the Minister of Finance has been a model of close co-operation so far. This is remarkable because in some other developing countries such relationships are not so cordial and close. There are often divergences of objectives. The Treasury favours an expansionist policy for political reasons while a Central Bank is more cautious in its monetary policy, because it is always worried about margins of safety between the money supply and the backing of it, for example. Thus a weak Governor who submits to the Government's pressure will spell disaster to any developing country.

In the case of Malaysia, none of these things happened so far. In fact, such tendency of the Government to resort to the Central Bank to finance its budget deficits which will lead to an unhealty inflation will not be carried out, as ssured by the Minister of Finance when introducing the Central Bank Bill in 1958:[3]

> Let me say clearly and unequivocally that the Government expects the Central Bank to be able to do a great deal towards developing an awareness among the people in the Federation of the need to save and invest but it does not intend the Central Bank to be used as a note-printing machine to gratify irresponsible demands for finance for development or other purposes, however worthy the cause may appear to be.

Although the Bank may grant temporary advances to the Government for temporary deficiencies of budge revenue, the total amount of such advances is limited to a maximum of 12½% of the estimated annual revenue receivable by the Government; and such advances must be rapid within three months after the end of the Government's financial year. Should any balance remains unpaid, The Bank is not allowed to make more ways-and-means advances.[4]

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3 Sir Henry Lee, "Speech Introducing and Second Reading of the Central Bank Bill" - Federal Legislative Council, Oct. 23, 1958.

4 Section 33, Central Bank of Malaysia Ordinance, 1958.

Thus, there are safeguards to the Government's capacity of using the Bank as an easy way out to finance its activities.

The Bank's relationships with other organs of the Government have been satisfactory generally. The State Governments have always sought the help of the Central Bank in their economic planning work and it is expected to continue in the future.

What should be the role of the Bank in future ?

So far the Bank has succeeded in achieving its prime objective of warding off serious inflation and depression in the country. The building up of a sound banking traditions has also been achieved. It success in achieving monetary stability has been through rigidly keeping down the supply of money according to the genuine needs of the business community and other sectors of the economy. The Malaysian currency has always been stable as indicated by price stability in the country. Further, there has been a gradual but sure increase in commercial banking activities in Malaysia. In 1959, there were only 24 banks and 104 banking offices but by the end of 1968, there were 38 banks and 314 banking offices. The total resources of the commercial banks also grew. At the end of 1968, total resources of the commercial banking system were about $3,500 million compared with $1,000 million at the end of 1959.

In the future the Bank is expected to carry on the good work it has so far achieved as outlined above. Also it is expected that the Bank will play a more active role in monetary policy as part of the Government's overall economic policy. It is, therefore, the main aim of the Governor, as the chief executive of the Bank, to attempt to build up a body of traditions, among which are traditions of absolute integrity, competency, efficiency and continued and dependable expertise in economic affairs generally and in monetary matters particularly. The respect and influence that Bank Negara Malaysia has on the general public, commercial banks, on economic and financial policies of the Government depends on the aforementioned virtues and standards that the Bank is able to develop and maintain.

Specifically, in future the bank is expected to play its monetary management role in the following areas of activity, assuming that the Bank's aim is help economic development of the country with stability:

(1) It can help finance government spending, although it must not be carried out excessively for reasons noted earlier.

(2) It can alleviate the effects of foreign trade fluctuations on the level of domestic activity and prices and

(3) It can promote the sound expansion of ordinary banking and credit facilities to the level which is comparable to that of the Western developed world.

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